

**CONCURRENT RESOLUTION ON THE
BUDGET FOR FISCAL YEAR 1997**

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Concurrent Resolution on the Budget...

HEARINGS

BEFORE THE

**COMMITTEE ON THE BUDGET
UNITED STATES SENATE**

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

March 6, 1996—THE CURRENT STATE OF THE ECONOMY, THE ECONOMIC OUTLOOK AND THE ROLE THAT PRUDENT FISCAL POLICY CAN PLAY IN ENHANCING LONG-TERM PROSPECTS

March 12, 1996—IMMIGRATION AND PUBLIC WELFARE BENEFITS

March 14, 1996—BUDGET AND ECONOMIC IMPLICATIONS OF ALTERNATIVE SPECTRUM USE POLICIES

March 20, 1996—THE PRESIDENT'S FISCAL YEAR 1997 BUDGET

April 18, 1996—THE ECONOMIC OUTLOOK FOR FISCAL YEARS 1997-2006



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CONTENTS

HEARINGS

	Page
March 6, 1996—The Current State of the Economy, The Economic Outlook, and The Role that Prudent Fiscal Policy Can Play in Enhancing Long-Term Prospects	1
March 12, 1996—Immigration and Public Welfare Benefits	69
March 14, 1996—Budget and Economic Implications of Alternative Spectrum Use Policies	149
March 20, 1996—The President's Fiscal Year 1997 Budget	253
April 18, 1996—The Economic Outlook for Fiscal Years 1997–2006	327

STATEMENTS BY COMMITTEE MEMBERS

Chairman Domenici	1, 69, 149, 253, 306, 327
Senator Abraham	76
Senator Boxer	144, 251
Senator Conrad	151
Senator Dodd	398
Senator Exon	2, 73, 270, 328
Senator Frist	76, 289
Senator Grams	402
Senator Gramm	152
Senator Grassley	269
Senator Lautenberg	39
Senator Simon	77
Senator Snowe	42, 250, 270, 311, 403

WITNESSES

Baily, Martin, Member, Council of Economic Advisers	23
Borjas, George J., Professor of Public Policy, John F. Kennedy School of Government, Harvard University	110
Burgess, Mike, General Manager, KOB-TV, Albuquerque, NM	194
Capra, James R., Capra Asset Management	6
Darner, Karen, Virginia House of Delegates, on behalf of National Conference of State Legislatures	128
Hausman, Jerry, MacDonald Professor of Economics, Massachusetts Institute of Technology	219
Hazlett, Thomas W., Visiting Scholar, American Enterprise Institute, and Director, Program on Telecommunications Policy, University of California, Davis	227
Irving, Larry, Assistant Secretary for Communications and Information, United States Department of Commerce	175
Levy, Mickey D., Senior Vice President, Chief Financial Economist, NationsBanc Capital Markets, Inc.	11
Martin, David A., General Counsel, Immigration and Naturalization Service, U.S. Department of Justice, accompanied by Toni Marwitz, Visa Officer, U.S. Department of State and Lavinia Limon, Director, Office of Refugee Resettlement, U.S. Department of Health and Human Services	78
Moore, David H., Senior Analyst, Congressional Budget Office; accompanied by Perry Beider, Natural Resources and Commerce Division, Congressional Budget Office	153
O'Neill, June E., Director, Congressional Budget Office	332
Rivlin, Alice M., Director, Office of Management and Budget	254

	Page
Shrier, Howard, President-elect, Nebraska Broadcasters Association	197
Tajima, Mark, Analyst, Los Angeles County Chief Administrative Office	119

ADDITIONAL MATERIAL

Questions and answers—Committee members to witnesses, written:	
Dr. Rivlin	312
Statement:	
Becerra, Xavier, Congressman (D-CA)	145
Articles:	
Free the Airwaves	234
Spectrum Auctions—Only a First Step	238

THE CURRENT STATE OF THE ECONOMY, THE ECONOMIC OUTLOOK, AND THE ROLE THAT PRUDENT FISCAL POLICY CAN PLAY IN ENHANCING LONG-TERM PROSPECTS

WEDNESDAY, MARCH 6, 1996

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:06 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Grassley, Brown, Gorton, Snowe, Abraham, Exon, Lautenberg, Simon, and Conrad.

Staff present: G. William Hoagland, staff director; and Amy Smith, chief economist.

For the minority: William G. Dauster, democratic chief of staff and chief counsel; and Jim Klumpner, chief economist.

OPENING STATEMENT OF CHAIRMAN DOMENICI

Chairman DOMENICI. Can we get started? Senator Simon, I have been told by Senator Exon's staff that we ought to go ahead and proceed.

Senator SIMON. Fine.

Chairman DOMENICI. What I would like to do is get to the witnesses and let everybody get their opening remarks as they inquire. Rather than have long opening remarks from everyone, I thought maybe Senator Exon and I could give a brief opening and then go to the witnesses. Then with each of you, as we do it in order of arrival, as the distinguished Senator from Nebraska has regularly insisted—

Senator SIMON. I am even willing to waive your statement and Senator Exon's. [Laughter.]

Senator EXON. I object.

Chairman DOMENICI. Mine is very, very brief. Senator Exon, now that you have arrived, for the record and for you and so you can dispense this to your members and us to ours, obviously there is some flux with reference to the schedule for the next couple of months, depending upon the outcome of the debt limit extension and the omnibus appropriation bill. We were scheduled to hear Mr. Greenspan tomorrow. However, I understand that because he has not been officially reconfirmed, he has advised the committee that he cannot testify until he is reconfirmed, or that he won't. There-

fore, the hearing for tomorrow on Dr. Greenspan has been postponed.

Two hearings have been scheduled for next week: on the 12th, which is Tuesday, the budgetary impact of public assistance benefits for non-citizens, and on Thursday, March 14, the budget impact of alternative spectrum option proposals. In both of those cases, as we work our way through negotiations, those two issues remain very, very contentious in terms of the real impact of the spectrum option and the impact of non-citizens getting benefits, to whatever extent it is.

So we won't be having hearings on legislation but, rather, on the concept. As you know, on the option you are going to bring somebody from a State like yours, and I am going to bring one from a little more rural State to talk about the impact as we hear from CBO on the options. That is our general plan, and I have cleared that with you.

The following Monday, on the 18th, the President will release details of his 1997 budget. I am hopeful that that will be a real budget, a total budget. I have been cautious in my remarks and will await release details. The committee will receive testimony from the OMB Director the next day, on March 19th. No further hearings have been set, but I expect that we will want to clarify some of the Administration's proposals in their total budget. And we will consult with you, Senator Exon, as we attempt to arrange that.

Now, I don't know yet when we would be expected, Senator Grassley, when we might mark up the 1997 budget resolution. We have not consulted yet, nor have I made a decision. It is entirely possible that we may not do anything on that until after the April recess. It is possible that if things break right, we might do it before we go on the recess. But we will be in touch with you regularly, Senator Exon.

OPENING STATEMENT OF SENATOR EXON

Senator EXON. Mr. Chairman, thank you very much, and I have not been advised officially by you or anyone else, but I have picked up several reports through the grapevine and other parts of the information services that flow back and forth through the cloak room and otherwise that in all likelihood we, unfortunately, will put off the decision-making process on the budget until after the April recess. I would hope that we would move aggressively ahead on these things. I will be glad to work with you in that regard. As we take up this brand new budget when we haven't finished last year's work, it puts this committee in a most difficult position, it seems to me. And I simply want to offer you, Mr. Chairman, my cooperation and that of the minority members of the committee in the hopes that we will be consulted in some detail on these matters as we proceed.

No decision has been reached yet, as I understand it, although there was an interesting story in the Washington Post this morning that is not official but probably was a fair estimate of at least where I think we are coming from at the present time. So, therefore, despite the divisions that we had last year, this is a brand new year, and I hope that we can go into this with some kind of a bipartisan approach, because the budget deficit and the continu-

ing raising of the National debt is not a partisan issue. It has to be faced by all of us jointly. We are all responsible for action or inaction, depending on your point of view.

I simply say that I hope we can work in a fashion that is in the interest of the United States of America, and I pledge my efforts in that regard. That might break down through the political process that we have, especially in a Presidential election year. But, nevertheless, I wish to start out with an offer, once again, of being in cooperation wherever and whenever we can. I think that is a step in the right direction.

I do have an opening statement that I would like to make, probably hoping to set the tone for this hearing and the ones that will follow. I am disappointed to hear that Mr. Greenspan felt that he could not come tomorrow, because I am certain that Mr. Greenspan has a direct bearing on the decisions of his agency that are essential to what we do or don't do with the continuing markup, and collecting the figures that are obviously necessary if we are going to do as honest a job as possible at resolving the various issues that confront us.

I do want to join you in welcoming the distinguished panel that we have today, and we are trying to reach into the current state and the future state of the economy, which, as you all know, is what the budget process is all about. I hope we can have a serious discussion about economic growth and not waste our time simply bashing the President.

The truth is that the American economy is sound. Under President Clinton's stewardship, the economy has performed beyond expectation. Nearly 8 million new jobs have been created, 93 percent in the private sector, I would emphasize. The so-called misery index of inflation and unemployment is at the lowest level in about three decades. The Clinton administration should be complimented for not everything that it has done, but the sound approach that I think has been evidenced by the Clinton administration since they have brought about downturns in the deficit for 3 years in a row, and nothing like that has happened since the days of President Harry Truman.

We have a broad bipartisan consensus that the Government should balance the budget. I hope we can continue with that on some kind of a reasonable basis. Yet there are some problems with the economy that the President is the first to say that we must address. He did so, I would point out, in the State of the Union message.

Finally, climbing into the middle class and staying there is getting harder and harder and harder for those people who generally are described as middle-class Americans. Productivity keeps going up, but wages don't. The purchasing power of most workers' wages has fallen for the past two decades. Many breadwinners find that one job will no longer do it. It takes two workers, sometimes with two jobs each, to make ends meet.

Now, Mr. Chairman, I simply want to emphasize that there is continuing anxiety among American workers, and it is very obvious and it is very thick. A recent poll found that a staggering 72 percent of those surveyed believed that layoffs and the loss of jobs will be a very permanent problem. The wholesale firing in America's

blue-chip companies—I won't dignify it by calling it simply "downsizing," which is a new word that does not properly describe the real problem that we have in America. That has left hundreds of thousands of Americans broken and feeling betrayed.

When I ran a business myself, firing a big chunk of the staff was a sure sign in those days of failure and incompetence at the leadership levels. But yesterday's bum is lionized as today's savior evidently only for the good of Wall Street. Many are appalled with the enormous gap between executive salaries and worker pay.

Business Week, no bastion of liberalism, I would point out, states in the February 19 editorial,

Despite big gains in productivity and profits, most employees are not sharing in the rewards while shareholders and the option-laden corporate officials most definitely are. The rising economic tide that once lifted everyone in America is now playing favorites, and people don't like the new rules.

Indeed, it has become a riptide for countless Americans who are being dragged out to sea with no life preserver whatsoever. A study last year of the earnings of nearly 300 chief executives and their officers found that they made on average 187 times as much as their average worker, up from 41 times as much 20 years ago. In fact, the study predicts that by the year 2010 the average CEO will be earning multiples of the average worker's pay that have not been seen since 1789, the days of the difficulties in France that followed the Revolution. And we all know what happened then.

I don't profess to have the answer to all of these problems, but as a recent editorial in the Lincoln Journal Star said, and I quote, If we want more job security in this system, there is probably a way for Government to help us get it. But we must realize that comes at a price, too, for the economy is much more than just a bunch of numbers.

That is something that was all too often missed in last year's budget debate. There are people behind these numbers. And what the majority missed last year, I believe, is that it is not just balancing the budget, but how we do it that is finally important. It is not just balancing the budget but keeping people working through programs like the earned income tax credit and others. It is not just balancing the budget; it is keeping our priorities straight as we do it.

So once again, Mr. Chairman, I welcome our witnesses to this very important discussion today that leads off what I think will be some very informative hearings under your direction as the chairman of our committee. I look forward to hearing the views of this panel on the state of the economy and what we can do to ensure that all Americans will still share in the American dream.

Mr. Chairman, I thank you.

Chairman DOMENICI. Thank you very much, Senator Exon. I think you misunderstood my opening remarks. While I gave you an agenda of what was to come, you assumed that was my opening statement and, therefore, gave yours before me. But that was a great opening statement, and I don't mind at all. I ask that mine be made a part of the record as if read.

[The opening statement of Chairman Domenici follows:]

OPENING STATEMENT OF CHAIRMAN PETE V. DOMENICI

This first hearing of the committee for this year falls at an excellent time given the uncertainty over the current economic and budget outlook.

After expanding 3.5 percent in 1994, U.S. growth eased to 2.1 percent last year. While pockets of the economy (like my home State) did quite well, overall 1995 growth was the slowest since 1991's recession. Although weather has played a role recently, there are deeper areas of concern in the interest rate sensitive sectors—high housing inventories, a consumer debt build-up and lessened business investment given an easing of capacity constraints.

The 50 basis point backup in long-term interest rates last month does not bode well for these concerns. If the slowdown does continue, it will make our underlying economic problems more visible and thus will require more immediate policy response.

Foremost among these economic Achilles heels is the budget deficit. While some growth, combined with the large tax hike of 1993 and the completion of the savings and loan crisis, has seen the deficit decline since 1992, clearly we can't rely on this forward. We will have to deal with the underlying cause of fiscal excess—entitlements.

I am most concerned about what happens into the next century. Without action, the United States private debt to GDP ratio will soar to a staggering 300 percent of GDP by 2030 from its current 52 percent level. We undertook a serious program of deficit reduction last year—one which would eliminate the deficit by 2002 while controlling the explosion in entitlements. Although the Administration vetoed the Balanced Budget Act of 1995, we must continue to push forward this year with renewed vigor.

Although budget deficit reduction may sound antiseptic in isolation, I believe it has overarching implications for our children.

As I have said many times, accumulated deficits impose an explicit tax on our children because they will have to pay tomorrow for our irresponsibility today. Furthermore, it will be harder for them to pay since the deficit will also act to hold back wage growth and standard of living improvement.

With more and more resources going toward government programs, Americans have less and less left to invest in themselves. American's frustration with these issues is evident already.

This is understandable when one compares current conditions to those of the 1960s. Compare a meager 0.9 rise in productivity and a 0.4 percent rise in average compensation from 1973–1993, with a healthy 2.5 percent productivity gain and 2.4 percent rise in wages during the 1960s.

Why the difference? While many factors contribute, the encroachment of government via excessive tax and spending policies, government regulations, and a tax code which discourages savings have all played a major role. We must seek to undue this. Undoing this by reining in entitlement growth and reforming out tax code.

We are very fortunate to have a distinguished panel of witnesses with us today, who can shed light on these issues. We look forward to hearing both what you see as the short-term economic outlook and your prescriptions on how best to ensure long-term, sustainable growth.

Chairman DOMENICI. I just want to say this is the first in a series of hearings. We have a very difficult job ahead, because the vulnerabilities of this year's situation just pile up on this committee in terms of what we have to do. I think we ought to all know we have got to do a budget resolution, because the Government can't and Congress can't proceed without it. So for those who want a balanced budget and think there are some good ideas, obviously we will have another chance here in the next 6 to 8 weeks.

Frankly, I would like to hear today from witnesses who will tell us what is going on in the American economy. I would like them all to discuss with us what is going on with interest rates. I hope we can find out from them what the long-term interest rate picture looks like. I don't think there is a better barometer of whether we are going to have worker security than to have long-term interest rates come down and stay down, and the converse or the flip side is sure true. If we have a continuation of the spike that has oc-

curred in long-term interest rates and if that continues on up and becomes a part of our life, then the issue of job security that we are talking about today in a rather stable economy that has seen at least some sustained growth and some adjustment to very changing times will clearly fail and things will be very difficult for jobs, for American companies, and for prosperity.

I hope we can also get some evaluation from some of you as to whether deficit reduction is all the same or whether there is some kind of deficit reduction that has more of an impact over the long haul for America. And I guess I would just be honest with you. It looks to me like the only thing we are going to do to save any money this year is ratchet down appropriations. It looks like we are going to save about \$22 billion. Perhaps we will get nothing else of any significance during the year, and I would like to have some observation from one or all of you as to if we don't get entitlement reform soon and get the spiraling costs of the entitlement side of the ledger under control, what is the next century going to really look like in terms of American prosperity?

I know each of you came with different ideas in mind, and we are going to hear from you. But I very much would hope that you would give us the benefit of your insight, background, and wisdom based upon some of the questions I have put forward and the instructions that we sent to you in inviting you.

With that, let's proceed. Mr. Capra, you are going to be first. How much time do you think you need to summarize and give us a good oral statement of what your remarks are about?

Mr. CAPRA. Not long. I just have a couple of simple points—you know, 3 to 5 minutes, 3 minutes maybe.

Chairman DOMENICI. You should take a little more than that. Why don't we give you 10 to 15 minutes for your remarks? And, fellow Senators, you will each get 5 minutes added to your normal inquiry time for any opening remarks that you might want to make.

Please proceed.

STATEMENT OF JAMES R. CAPRA, CAPRA ASSET MANAGEMENT

Mr. CAPRA. My testimony this morning presents a difficult challenge because, you know, this committee is expert in the budget and the economy. So how can I tell you something that you either don't already know or haven't already heard?

What I am going to do is draw on my area of expertise. I am a money manager, and in that capacity I invest tens, sometimes hundreds of millions of dollars on a daily basis throughout the world. My main area of expertise where I make the most money for my clients is in the U.S. credit or interest rate markets, and because of that, my prepared remarks today are really going to focus on my professional opinion as to—on a relatively narrow subject, my professional opinion on the near-term effects on the credit markets of balancing the budget.

In particular, what I want to concentrate on, because there are probably a lot of questions back and forth on what the effects have been, I want to concentrate on what has happened to interest rates after the breakdown of budget negotiations, and also I want to offer

some suggestions as to what might have happened if a credible budget agreement had been achieved.

I will conclude with a few observations about what kind of response you might expect from the credit markets over the next several months from various actions related to the budget.

Let's just first look at what has happened. Long-term interest rates declined by about one-half to five-eighths of a percentage point—in the credit markets, we would call that 50 to 60 basis points—between mid-September of last year and the beginning of January of 1996. Now, I attribute a significant part, if not all of that decline, to market optimism about fiscal policy.

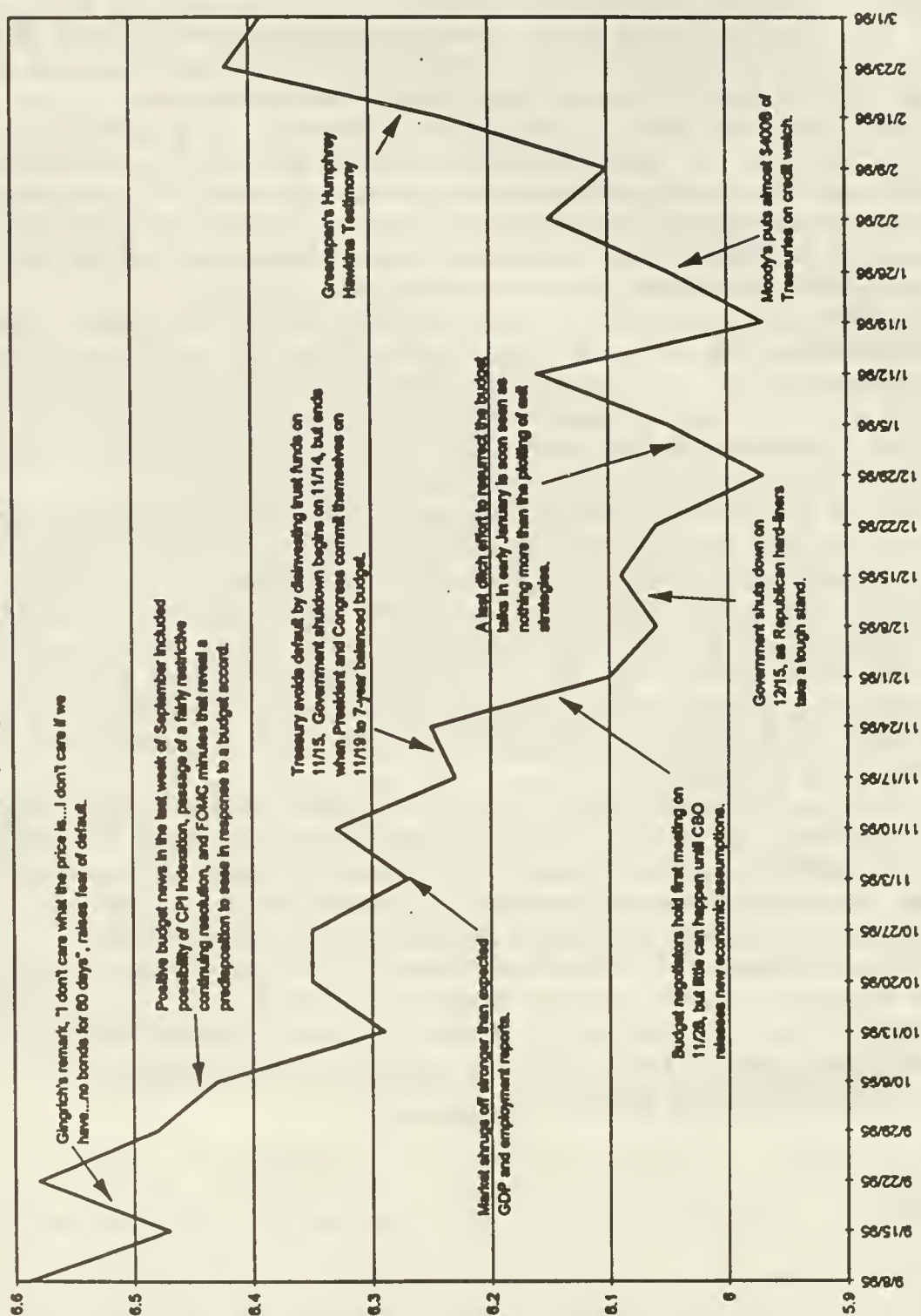
Market participants had been vaguely aware that there was a budget-balancing bill and legislation working its way through the Congress. But it really came to a head, or we became more aware of it, when Speaker Gingrich talked about holding up the debt ceiling and various appropriations bills on the 21st of September. After that, we began to follow the issue much more closely.

One of the most interesting aspects of the rally in the credit markets from late September through January was that it occurred in an environment where most economists—Mickey maybe is the exception, but most economists were very optimistic about the U.S. economy. GDP growth was reported to have grown by 4.2 percent in the third quarter on the 27th of October and then a few days later, the unemployment rate was reported to have fallen to 5.5 percent, with hourly earnings jumping by half a percent and the work week going up.

These are normally events that would have created a back-up in the market of 20 basis points or 30 basis points or more. Generally, credit markets, as you know, if the economy is moving too fast or they are worried about the economy moving too fast, become worried about inflation, excessive credit demands and so forth.

What happened, if you look at the chart, is that within days after the release of those reports, long-term interest rates reached the lowest levels they had achieved since the early part of 1994. Now, I attribute most of that decline to optimism about fiscal policy and to budget-balancing policy.

Treasury 30-yr Bond Yield (in percent)



Now, that optimism came crashing down in early January when negotiations between the White House and the Congress broke down. This market sell-off, was somewhat diminished or muted because the economic consensus also shifted in early January. Most economists started to believe the economy was softening. Some were even talking about recession. And, consequently, short-term interest rates declined significantly in the month of January, and early February, and that mitigated some of the rise in long-term rates that was occurring because of the failure of the budget-balancing action.

One of the measures of that is to look at the spread between short-term and long-term interest rates. If short-term interest rates are going down and long-term interest rates are stable, it is like one of those environments where you figure that the Fed is going to be easing policy and people are less optimistic about the long run. But what happened in the month of January is the spread between short- and long-term interest rates increased by 50 basis points, or half a percentage point. So my argument is that interest rates at the long end would have risen a lot more if it were not that the economic consensus shifted to a weaker economy early in the month of January.

As of now, if you want to look at this, the rates declined at the long end from 6.6 percent to 5.95 percent in early January. Subsequently, this morning I think they have gone back up to about 6.4, 6.45 percent. And I would argue they would be up at 6.6 percent if it wasn't for this kind of change in the consensus about the economy.

This isn't the only cost, really, of the failure of budget reduction. I think you have to look at what might have happened if, in fact, a successful agreement had been carved out between the President and the Congress. It is kind of an exercise in what might have been, and as I refer to in the testimony, to a certain extent it is like saying what would have happened in the Super Bowl if Neil O'Donnell hadn't thrown that interception. Would Pittsburgh have won or not?

We can't be sure what would have happened, but I think you can piece together several factors that suggest that interest rates now at the long end would be somewhere between 5.5 and 5.75 percent instead of closer to 6.5 percent if a deficit reduction package had been enacted.

The first factor that I think plays on this is the Federal Reserve. It is unfortunate you are not going to hear from the Chairman tomorrow, and he will probably answer this himself. While it is true that the Fed did lower the funds rate by 25 basis points in late January, that cut, I would point out, was only accompanied by a 25-basis-point cut in the discount rate. Now, that cut in the discount rate was the smallest change by the Federal Reserve in the discount rate since 1978. And I would argue that the move the Fed made in late January was really a very grudging one and may not be followed by further cuts in short-term interest rates unless the economy shows much more weakness than we see right now.

Now, the market has only become recently sensitive to this issue and the fact that the Fed may be dragging its feet a little bit, and that is why short-term rates have spiked in the last week or so.

Conversely, I believe that if the budget deal had been concluded, Fed policy would be much more promising. If you were a central banker, you would be looking at fiscal restraint in 1996 and 1997, a reduction in inflation expectations, a rising dollar, and that is an environment under which, as a central banker, you start to plan out a series of short-term interest rate cuts, because, remember, as the famous gentleman on my left I think would agree, the lag between Fed action and the effect on the economy can be anywhere from 12 to 24 months. So the Fed would have to be starting to move now to offset the fiscal restraint that would be in place because of the budget reduction efforts.

I think all of those factors combined would have driven interest rates at the long end to the lowest level since the 1960's.

A second factor that would have changed things, I think somewhat, is the international environment. Interestingly enough, we kind of get isolated on our own shores here when we look at the budget reduction efforts. But, interestingly enough, just weeks after the failure of the Congress and the President to reach a deficit reduction package, some of the countries in Europe which had been moving forward on their own deficit reduction packages as part of the requirements for the Maastricht Treaty, where they have to get their deficits down to 3 percent of GDP, some of those countries began to have second thoughts about whether they should continue to pursue their efforts. In fact, in January, France and Germany decided that maybe they should start talking about injecting fiscal stimulus.

Now, what happened there was German interest rates in the 10-year sector increased by 60 basis points, and interest rates throughout Europe have backed up, despite much more pervasive weakness in Europe than we find in the United States.

Now, in my mind, there is little doubt that if the United States had enacted a bold fiscal plan, the Europeans would have felt compelled to stick to their own plans. And lower European interest rates would have had a salutary effect on the situation here. It would have stimulated their economic activity; it would have allowed us to have stronger exports; and our economic outlook would have looked somewhat better.

Now, let's return from what might have been to the current situation. I am a bond market trader, so I am just going to tell you what I am looking at. Two months ago, I was looking at a 7-year balanced budget, some attempt to restructure entitlements, and fiscal restraint. Today I am looking at no 7-year balanced budget, no effort whatsoever that I can see to enact restriction on, or changes in entitlements, and I am hearing discussion of fiscal stimulus—tax cut packages with no offsetting reductions and so forth. And so that is not a particularly great environment to own bonds in.

Now, one measure of the market's pessimism about the budget, I would argue, is its intraday response to statements by the leadership—Senator Dole, Speaker of the House Gingrich, and the President.

In December and early January, when they would come over the tape saying that they thought a balanced budget was within grasp, the market would rally, you know, half a point—I mean, about 3 to 5 basis points, and then wait and see what happened. Right now

the market just completely ignores it. The market basically assumes that nothing is going to happen at the moment.

For my own part, I am somewhat worried that having come so close to a budget deal and failed, we are going to find ourselves slipping farther and farther away from budget and entitlement reform similar to, as I think Senator Domenici and I remember, what happened after the attempt to restrict Social Security COLAs in the early 1980's. It took basically 10 to 15 years to get back on track to try to rein in the Federal budget.

Chairman DOMENICI. Thank you very much. I personally am glad that we talked you out of 3 minutes and gave you 12.

Senior Vice President and Chief Economist of NationsBanc Capital Markets, Dr. Levy, you are next. How much time would you like, 10 or 15 minutes?

Dr. LEVY. That would be fine.

Chairman DOMENICI. All right. Give him the same amount of time. That is fair enough.

**STATEMENT OF MICKEY D. LEVY, SENIOR VICE PRESIDENT,
CHIEF FINANCIAL ECONOMIST, NATIONSBANC CAPITAL
MARKETS, INC.**

Dr. LEVY. Mr. Chairman and members of the committee, I appreciate the chance to be here today and provide my views.

The economy is very sound structurally, but weak cyclically. The probability of recession remains low, as heightened business efficiencies and the Federal Reserve's disinflationary monetary policy have reduced potential disruptive imbalances in the economy.

However, the Fed's sustained monetary restrictiveness has generated undesirably weak economic growth, and I forecast the cyclical slump to continue through mid-year 1996. Inflation has begun to recede, and I see inflation falling at least through 1997. This environment of modest economic growth and declining inflation will remain favorable for financial markets.

The structure of the economy paves the way for sustained economic expansion, but the crucial issue is at what pace, and what can policymakers do to enhance the rate of economic growth. I contend that the Fed has pursued a low inflation environment. The business community has become very efficient, and the missing ingredient to stronger economic growth is lack of fiscal reform.

With regard to the cyclical slowdown in the economy, the recent weakness that has been generated by the monetary restrictiveness in 1994-95 which slowed demand, as evidenced by trends in retail sales, consumption, auto sales, and housing. In response, businesses have trimmed production, and slowed investment and hiring. The Government shutdown and delayed budget negotiations have aggravated the economic weakness.

Certainly the Fed's pre-emptive monetary tightening in 1994 helped orchestrate the soft-landing in 1995 and paves the way for lower inflation. But my biggest concern right now is the Fed is remaining too tight. Keep in mind, in 1995, three of the four quarters had less than 1 percent real economic growth. And I expect sluggish growth to continue.

In this regard, note that aggregate demand in the economy remains weak despite the significant decline in interest rates in the

last 12 months. I am not surprised. Rates have declined as a reflection of the economic weakness while monetary policy remains restrictive, as measured by the narrow monetary aggregates. We still see the Fed draining real liquidity out of the system, so the decline in rates has provided a nice cushion, but it is not stimulative. I encourage the Fed to move monetary policy toward a neutral stance.

Chairman DOMENICI. Maybe I could just ask you, am I reading right that if you were President, you would not have reappointed Dr. Alan Greenspan?

Dr. LEVY. Oh, I would certainly reappoint him, and I would say bluntly he is—the Fed is—the only credible game in town.

Chairman DOMENICI. So whatever they haven't done right, they are still better than most.

Dr. LEVY. Senator, I think the Fed has done a marvelous job of building inflation-fighting credibility and paving the way to sustained growth. Yet I think at this point the Fed is misreading some of the statistics. Businesses have gone out of their way to increase capacity, while the Fed's restrictiveness is constraining demand. The weakness in the economy now has nothing to do with the structure, and everything to do with slack demand. But that is minor compared to the overall job the Fed has done.

Businesses, in response to the slow aggregate demand, have become cautious—in production, in inventory building; in their investment plans; and in hiring. I expect that to continue until we see a pick-up in product demand, and I don't expect that in the first half of this year.

Underlying this cyclical weakness, the structure of the economy is extraordinarily sound. Unit labor costs in the United States are low relative to international competitors, and unit labor cost inflation is low. Levels of corporate and household debt service are modest relative to corporate profits or household income. Inventories are at manageable levels and the banking sector is strong. Business efficiencies and their very rapid responses to slower demand, combined with the Fed's inflation-fighting credibility, has eliminated potentially disruptive imbalances that in the past have sidetracked the economy. This lowers the probability of recession and increases the probability of sustained expansion.

I completely agree with Jim Capra that credible fiscal policy would lower interest rates. The primary reason why rates are lower this year than last year is weak economic growth that reduces the equilibrium level of real interest rates and the Fed's inflation-fighting credibility that lowers inflationary expectations. My outlook is a little more sanguine than Jim's. Given my very optimistic outlook for inflation, I think long rates will continue to come down. But there is a limit to the extent to which they can fall; a fiscal compromise is essential.

I would like to make a few remarks about labor markets and wage trends. Recently, corporate layoffs have generated a growing sense of job insecurity, the real wages of laborers have languished, and wage and income differentials between skilled and unskilled workers have widened. Several clarifying points are necessary to avoid bad public policy.

First, total employment continues to grow, so clearly new jobs are more than outpacing layoffs. Second, the lack of real wage

growth reflects years of very rapid growth in non-wage compensation and international competition. By the late 1970's, U.S. unit labor costs were dramatically higher than other industrialized countries. So this has been a long-term adjustment process. If real wages had not languished, huge job losses would have occurred. The price and wage adjustments mitigated the impact on the labor markets. High taxes on wages also drives a wedge between productivity and wages.

Also, I might note that most economists recognize that the average hourly earnings index is quite flawed, while other measures show that total earnings are rising in real terms.

The third point is that production innovations and the internationalization of the labor markets have lowered the demand for unskilled workers and raised the demand for skilled workers, and this explains a large part of the widening wage and income differentials.

Growth-enhancing remedies for narrowing these differentials and raising standards of living involve raising the education and skill levels of the low skilled, opening up international labor markets and encouraging labor mobility, and reducing taxes on labor and eliminating rigidities that inhibit the flow of labor in and out of jobs.

Policymakers must avoid populist initiatives that would cause more harm than good. Presently, I don't know what is scarier—the far right talking about protectionism or a new Democratic proposal which is basically industrial planning. Both of those would lower standards of living and, in fact, hurt directly the people they are intended to help.

The simple point is that if you inhibit the flow of labor, like in Europe, and try to close those wage and income differentials the wrong way, you end up with double-digit unemployment rates. So there are trade-offs. And here policymakers must be very careful about addressing the problems and not the symptoms.

When will the economic cycle end, the cyclical weakness end? I think the Fed holds the key. I think they will be lowering rates more, and normal growth will resume. But my forecast for 1996 in economic growth is decidedly below the Federal Reserve's, the CBO's, and the Administration's. However I am much more optimistic than all three of those in inflation. The key point is the Fed has followed a disinflationary policy and business efficiencies have changed the mix of current dollar spending, with more real and less inflation.

In contrast, in the longer run, I am more optimistic than the CBO or the Administration about the rate of growth. I think there have been advances in efficiency, although the recent chain-linked GDP measures fail to capture a lot of these efficiencies, particularly in the service-producing sector, and the productivity numbers don't show this increase in enhanced standard of living.

Fiscal reform remains a missing link. You could say we have established the foundation for sustained growth, but at what pace? I just can't emphasize enough that I think the Congress and the Administration focus too much on the deficit per se, which has receded, and too little on what we are deficit spending for—that is, how the budget allocates national resources and how the taxing

and spending structured underlying the deficits affect economic behavior.

Any meaningful fiscal reform must involve not just deficit reduction, but a reallocation of national resources from consumption-oriented entitlements to investment- and growth-oriented activities. You have to reduce non-means-tested entitlements, and this can be done in a fair way. I am very disappointed that adjustment in the COLAs weren't the linchpin to achieving a fiscal compromise.

Medicare reform, must reduce the demand for medical services rather than rely on price controls. The Government can provide stronger support for education, training, and public investment. The tax bias against saving must be addressed.

Let me give you a simple example about how all the rhetoric about deficits is missing the point. Right now, budget deficits in the United States are 2.3 percent of GDP. Everybody says, oh, if we eliminate the deficit, saving will increase a lot and everything will be perfect.

Well, the gap between the national rate of saving in the United States and major international competitors is about 10 percent points. So the deficit only constitutes about 20 percent of that difference.

Reducing the gap is not just a matter of arithmetic. It is a matter of economics. And the way in which you reduce the deficit has a crucial impact on investment behavior and on saving behavior. Witness the Clinton administration's deficit reduction package in 1993. There is no question, it reduced the deficit. But at the time, one thing they argued is that the reason why you want to reduce the deficit is to reduce the current account deficit.

Now, insofar as it relied heavily on tax increases, the reduction in the Government's dissaving by reducing the deficit was largely offset by a reduction in personal saving due to the raised taxes. So it simply redistributed wealth from the public sector to the private sector, and didn't increase national saving. The current account deficit widened.

This illustrates how deficit spending and the budget reallocates national resources not just arithmetically, but by affecting business incentives and household incentives. That is where policymakers need to focus.

A final point is that we are entering prime election season. It is dramatically important, as Jim said, that fiscal policymakers don't get sucked into putting forth a fiscal stimulus package to try to boost the economy. This would represent a move away from fiscal responsibility and a delay of the necessary reform that everybody on both sides of the political aisle know is needed, not just in the numbers deficit reduction, but in reforming medicare and Social Security.

The long-run payoffs to fiscal reform are huge. Above all, the fiscal policymakers should want to achieve fiscal responsibility. A one-quarter percentage point faster real GDP growth per year 20 years out would generate, in 1996 dollars, 5 percent higher GDP equal to about \$340 billion. The cumulative present value increase would be 32 percent of current GDP. Nobody knows how much fiscal reform would add to the long-term rate of growth, but that number doesn't sound outside the realm of possibility, and I cer-

tainly encourage this committee to push Congress back on track toward the fiscal reform because the economic benefits to society are huge.

Thank you.

Chairman DOMENICI. Thank you very much, Dr. Levy.

[The prepared statement of Dr. Levy follows:]

PREPARED STATEMENT OF MICKEY D. LEVY, CHIEF ECONOMIST, NATIONS Banc
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ECONOMIC CONDITIONS AND MICROECONOMIC POLICIES¹

Mr. Chairman and members of the committee, I appreciate the opportunity to present my views on economic performance and macroeconomic policies. The economy is sound structurally, but weak cyclically. The probability of recession remains relatively low, as heightened business efficiencies and the Federal Reserve's disinflationary monetary policy have reduced potentially disruptive imbalances in the economy. However, the Fed's sustained monetary restrictiveness has generated undesirably anemic economic growth, and I forecast the cyclical slump to continue at least through mid-year 1996. Inflation has begun to recede, a trend that will continue into 1997. This environment of modest economic growth and declining inflation will remain favorable for financial markets. The structural soundness generated by heightened business efficiencies and the Fed's disinflationary monetary policy create the foundation for sustained economic expansion, but a crucial issue is, at what pace, and what can policymakers do to enhance long-run economic growth? Fiscal reform remains the missing ingredient to support stronger long-run economic growth and higher standards of living. Policymakers must not simply pursue deficit reduction by any means possible, as the debate often leans; rather, true fiscal reform involves reducing deficit spending and reforming the tax code in ways that will raise the rate of national savings, reallocate national resources from consumption-oriented public uses toward more productive uses in the private sector, and eliminate the structural flaws in the spending and tax programs that generate costly economic distortions.

Current Economic Conditions. Recent economic performance reflects two general trends; the ongoing restructuring characterized by dramatic innovations and associated adjustments to production processes and labor markets, and the temporary cyclical slowdown in economic activity generated by the Fed's sustained monetary restrictiveness. The stalemate in the fiscal policy debate and the uncertainty surrounding it has aggravated the economic weakness.

The Cyclical Slowdown. The Fed's pre-emptive and aggressive monetary tightening in 1994 generated a sharp slowdown in demand, paving the way for the desired soft-landing in 1995 and preventing the widely anticipated cyclical rise in inflation. Inflation is expected to recede in 1996-1997, a favorable trend the Fed correctly recognizes as a necessary ingredient for healthy sustained economic expansion.

My biggest concern is that economic activity has slowed too much—annualized quarter-over-quarter real GDP growth was below 1 percent in three of the four quarters in 1995, following 3.5 percent growth in 1994—and that the Fed's restrictive monetary policy will generate a continued cyclical slump.

Similar to recent cyclical slowdowns, the weakness emerged first in housing and durable goods consumption. Real consumption, which grew 3.0 percent from Q4:93 to Q4:94, slowed to 1.9 percent in 1995, as auto sales fell and department stores sales slumped. Housing activity weakened sharply, with declining sales of existing and new homes forcing developers to cut back new construction in order to limit the rise in unsold inventories.

In response to mounting evidence of weak demand, businesses have slowed production and become increasing cautious. They have cut output in an attempt to control inventories, slowed investment growth and trimmed labor inputs. Industrial production rose a scant 1.5 percent from Q4:94 to Q4:95 compared to 6.6 percent in the previous year. Inventory building dropped below \$20 billion in Q4:95 from an average \$60 billion in 1994. Absent a rebound in product demand, a further re-

¹ The views expressed in this testimony are those of the author and do not necessarily reflect the views of the management or employees of NationsBanc or NationsBanc Capital Markets, Inc.

duction in inventory building may be necessary. Also in response to the anticipated weakness in demand and slower growth in corporate profits and cash flows, because investment in producer durable goods and structures has slowed sharply to 5.0 percent annualized growth since Spring 1995, half its 1994 pace.

These cutbacks in production have involved a significant adjustment in labor inputs: non-farm payroll growth has averaged about 110,000 per month since Spring 1995, compared to its 294,000 average monthly gain in 1994, and overtime hours have been reduced over 8.0 percent in the last year. As a result, aggregate hours worked have barely grown since early 1995, following their 4.3 percent rise in 1994. This has slowed growth in disposable personal income. Growing uncertainties about job stability also have dampened consumer confidence.

The delayed budget negotiations in Washington and Government shutdown have subtracted from economic activity in several ways. The decline in real Government purchases has accelerated, subtracting from GDP. In addition, the Government shutdown and the resulting uncertainty have negatively affected a wide array of private businesses that rely on Government functions. The lack of fiscal credibility has a negative impact that cannot be quantified; at minimum, the stalled budget negotiations have contributed to the recent rise in interest rates.

A decline in the net export deficit is contributing positively to GDP, but largely because of slowing imports, a sign of weakness. Exports continue to grow robustly—9.4 percent annualized in the second half of 1995—despite weak economic conditions in Europe and lingering recessionary-type conditions in Japan. The abrupt slowdown of import growth to 0.5 percent annualized in the second half of 1995 from its earlier 8.2 percent pace reflects the slump in domestic consumption and a moderation of business fixed investment.

Improved Structural Soundness and Lower Inflation Reduce Probability of Recession. Potentially disruptive imbalances in the economy have been reduced by efficiencies in production and the heightened ability of businesses to adjust to fluctuations in aggregate demand, the Fed's credible disinflationary monetary policy, and the flexibility of wages and prices. This lowers the probability of recession and establishes a sound foundation for sustained economic expansion.

In recent years, the magnitude of the cyclical fluctuations of current dollar spending growth has been dampened by the Fed's more persistently disinflationary policies, which has reduced the adjustments necessary for businesses to modify production and control labor inputs, supplies, and inventories. Since 1980, each succeeding peak in nominal GDP growth has been lower, and every peak-to-trough swing in aggregate demand has been smaller. This reduces the potential for large disruptive imbalances.

Moreover, a wide array of innovations and improvements in production processes, strong growth in business fixed investment, and more efficient uses of labor inputs have raised productivity and constrained unit labor costs. Productivity gains have played a larger role fueling economic growth in this expansion than in recent expansions, while rises in labor inputs have been more modest. Unit labor costs in manufacturing in the United States are significantly lower than nearly all other industrialized nations. Very low unit labor cost inflation has enabled businesses to maintain margins. The resulting healthy profit gains have provided the cash flows necessary for investment and expansion, and reduced the burden of debt service. At the same time, improving production processes have kept inventories at manageable levels. Entering 1995, these improvements provided businesses a healthy buffer against the cyclical slowdown.

Businesses have cut down production and labor inputs more rapidly and efficiently in the current demand downdraft than in previous cycles, maintaining healthy productivity gains, profit margins and cash flows, in sharp contrast to all recent cyclical slowdowns. In a sense, the efficient business response suggests the unobservable but powerful impact of the Fed's heightened inflation-fighting credibility—that monetary policy will remain consistent with a moderate growth/low inflation environment and relatively small swings in demand.

Recent recessions have occurred as sharp deceleration in demand generated by the Fed's aggressive monetary tightening in response to rising inflation, coupled with slow business responses, have generated disruptive imbalances in the economy. Avoidance of those trends in both demand and supply reduces the probability of recession. The risk remains, however, that a persistently restrictive monetary policy generates a continued deceleration of nominal spending, making the adjustments necessary to avoid recession increasingly difficult.

Labor Market and Wage Trends. In recent years, a stream of corporate layoffs has generated a growing sense of job insecurity, real wages of laborers have languished, and wage and income differentials between skilled and unskilled workers have widened. These trends, many of which are prevalent throughout the industri-

alized world, are receiving substantial attention, and some clarification is necessary to avoid policy mistakes.

First, continued growth of employment suggests that big-headline layoffs have been more than offset by new hiring. The average duration of unemployment has not increased, although some evidence suggests that dismissals may have risen relative to voluntary job departures. Clearly, unencumbered by the rigidities that inhibit labor markets in other industrialized nations, the United States has significantly larger flows into and out of jobs. The continuous reallocation of labor is a source of economic strength and long-run job creation, and should not be overshadowed by highly visible layoffs.

Second, the lack of real wage gains reflects in part the rapid growth of nonwage compensation, the long-term effort by U.S. businesses to reestablish international competitiveness, and high taxes on labor. In addition, there are notable flaws in the average hourly earnings statistical series, including the deflators used to arrive at a measure of real wages; other measures of earnings show an improving trend. In the early 1980's, following a decade during which wage compensation growth soared while productivity declined, U.S. unit labor costs in manufacturing far exceeded those in other industrialized nations, driving down U.S. exports. The adjustment of wage compensation relative to productivity, along with the decline in the U.S. dollar, has reversed those fortunes. Recently, average real wages have resumed growing, a trend that should continue as nonwage compensation slows and real wages catch up to the sustained gains in productivity.

Third, production innovations and the internationalization of the labor markets have lowered the demand for unskilled labor and raised the demand for skilled workers, widening wage and income differentials. Empirical analysis confirms the obvious; actual and expected compensation is increasingly linked to education and skills.

Growth-enhanced remedies for narrowing wage differentials and lifting standards of living necessarily involve improving the education and skill levels of the low skilled, opening international goods and labor markets and promoting free trade, and reducing taxes on labor and rigidities that inhibit labor supply and demand. The crux of the problem is raising the value-added of low-skilled job entrants and workers, not reducing the real wages of high skilled workers. Subsidizing low-skilled, low-wage earners involves disincentives that raise unemployment; witness the double-digit unemployment rates throughout Europe. The misguided populist initiative of protectionism would reduce average real wages, suppress economic activity, and lower standards of living; ironically, it would be particularly harmful to the low income workers. It is crucially important that policymakers consider constructive, growth-enhancing measures of raising the wages and incomes of the low-skilled, and avoid wrong-headed initiatives that address the symptoms, not the source of the problem.

Positive Financial Responses. Interest rates have receded with the slowdown in real economic growth, lower inflationary expectations, and the associated belief that the Fed will reduce its funds rate target. These trends are projected to continue. The strength of the stock market has stemmed from the decline in rates, which raises price/earnings multiples, and production efficiencies that have lifted productivity and enabled businesses to maintain margins and achieve growth in profits and cash flows. The expected stream of future earnings has been enhanced by the perceived low probability of recession. Insofar as the improved structural soundness and the Fed's credible disinflationary monetary policy represent a departure from the 1970's-1980's, ranges of P/E multiples in those decades are not appropriate guidelines for the 1990's. Nevertheless, the largest risk to the stock market is softening corporate profits in a weakening economy.

More Cyclical Weakness Ahead. Product demand is projected to remain sluggish through mid-year, generating continued cautious business behavior. Retail sales and employment are not expected to rebound dramatically in February-March, suggesting that their January declines were not just weather-related. In response, business will modify production and hiring plans in order to reduce inventory building and operating costs. Real GDP, which grew an anemic 0.9 percent annualized in Q4:95, is projected to grow approximately 1.0 percent annualized in the first half of 1996.

This anemic growth is decidedly below the projections—and desired ranges—of official forecasts in Washington and most private forecasters. The Congressional Budget Office and the Administration both forecast 2.2 percent growth from Q4:95 to Q4:96, while the Federal Reserve's central tendency forecast is 2.0-2.5 percent. The Blue Chip Consensus, which has become less optimistic in recent months, projects 2.0 percent growth in calendar 1996. Economic performance likely will fall short of these expectations. At the same time, however, I project that consumer

price inflation will recede from its 2.8 percent rise in 1995 toward 2.0 percent by year-end 1996 and remain low in 1997, while Government forecasts are more pessimistic. The CBO projects the CPI to rise 3.0 percent in 1996 and 3.1 percent in 1997, the Administration projects 2.9 percent inflation in both years, and the Fed's central tendency forecast for 1996 is 2.875–3.25 percent. The Blue Chip Consensus forecasts a slight decline to 2.7 percent.

Federal Budget Implications. A sustained cyclical slump would negatively affect Federal budget outcomes. With a lag, weaker-than-projected growth of output and employment would suppress tax receipts and push up spending growth for unemployment insurance, welfare, and entitlement programs. The resulting rise in deficits above baseline projections would heighten the legislation required to balance the budget.

When Will the Economy Rebound Cyclically? While business investment and restructuring have expanded capacity and set the stage for healthier expansion, the Fed's restrictive monetary policy continues to generate decelerating aggregate demand and is the primary source of the cyclical slump. Accordingly, the speed and timing of a cyclical rebound toward trendline growth depends primarily on how quick the Fed adjusts monetary policy toward neutrality. The process is underway with the Fed's recent rate cuts, but more is needed.

The Fed's Restrictive Monetary Policy. Beginning in late 1994, the Fed's funds rate hikes were associated with year-over-year declines in bank reserves and narrow monetary aggregates, and a sharp flattening of the yield curve, clear indicators of monetary restrictiveness and accurate predictors of the cyclical slump. Even though the Fed has gradually reduced its funds rate target to 5.25 percent from 6.0 percent in the first half of 1995, it has not kept pace with the declining equilibrium level of interest rates associated with the weakening economic and credit conditions, and the result has been a continued contraction of real money supply. In 1994–1995, financial innovations have skewed the relative growth of the monetary aggregates; in particular, banks' practices of using sweep accounts in order to reduce required reserves have lowered bank reserves and M1. However, using the Fed's own estimates, adjusting bank reserves and M1 for the impact of sweep accounts suggest that monetary policy remains restrictive, although less so than in 1995.

It is particularly noteworthy that the most interest sensitive sectors of the economy—consumption of durable goods, business fixed investment and business investment in inventories—continue to weaken despite the decline in interest rates. I am not surprised; rates have declined as a reflection of weakening economic and credit conditions; while they have provided an effective cushion against economic contraction, they are not stimulative and are not a substitute for monetary easing.

The Fed's failure to ease appropriately stems primarily from its excessively cautious inflation forecast based on a perceived unemployment rate-inflation tradeoff. This Phillips Curve approach is a misleading basis for forecasting inflation and for conducting monetary policy. Inflation is driven by excess demand, not low unemployment or real economic growth; the Phillips Curve fails to capture productivity innovations (either positive or negative), changes in production processes, the industrialization of the labor markets, or other factors. Positive productivity innovations likely lower the natural rate of unemployment. But the bottom line is that nobody really knows what the natural rate of unemployment is, yet analysts talk as if they do and policymakers base policy on it.

Inflation has begun to recede, despite the unemployment rate remaining below earlier estimates of the NAIRU. The Fed misinterprets the low unemployment rate as an indication that the economy is operating full potential and grudgingly lowers its implicit assumption of the natural rate; in contrast, I believe the low unemployment rate has occurred as business investment and productivity gains have raised potential output and capacity, while restrictive monetary policy has constrained demand. That suggests inflation will decline further.

A sustained pickup in aggregate demand is expected to lag the Fed's move to monetary neutrality; until then, business will remain cautious in their production and hiring plans. Just as the Fed moved pre-emptively to short-circuit inflation pressures in 1994, presently it needs to ease policy to reduce the risk of recession. Importantly, doing so would be entirely consistent with the Fed's long-run objective of price stability. A sustained cyclical rebound is not expected until later this year.

The Longer-term Outlook. The economic outlook for 1997–1998 looks favorable; I project stronger growth than the CBO or the Administration (2.3 percent per year), or the Blue Chip Consensus (2.1 percent growth in 1997). My optimism for the next several years and beyond is based on favorable environment created by business restructuring and the Fed's heightened inflation-fighting credibility. These factors will generate continued healthy productivity gains, and will raise the portion of nominal spending that is real growth while reducing inflation.

My assessment is that productivity gains have tilted upward, although there is insufficient data to verify conclusively any structural shift. The empirical issue about the trend in productivity is complicated by the new chain-weighted GDP index, which reveals slower real growth and productivity gains than the fixed weight GDP series, but similarly fails to capture many of the obvious efficiency improvements in the service-producing sectors, thereby understanding rising standards of living. Even using the chain-weighted index, productivity growth has accelerated during the current cyclical slowdown, in contrast to every recent cyclical slowdown, and has been steady through the 1990's.

If sustained, seemingly small differences in real GDP growth are huge: sustained one-quarter percentage point faster growth would raise the level of GDP 5 percent in the 20th year, an equivalent of \$337 billion in 1996 dollars; in present value terms, the cumulative increase would be 32 percent of current real output, or \$2.13 trillion. Thus, the importance of lifting potential output overwhelms current concerns about how to address the current cyclical slump.

Recommendations for Pro-Growth Fiscal Reform. The major economic problem facing the United States is not the budget deficit *per se*, but rather the mix of deficit spending and the structure of the tax burden that combines to generate a misallocation of national resources that suppresses national savings, discourages work and investment, and constrains economic growth and long-run standards of living.

The unprecedented deficit spending in recent decades has been a result of rising outlays for entitlement programs, while taxes have remained fairly constant as a percent of GDP. As the mix of Federal spending has shifted toward a rising share for entitlements, a declining share of spending has been allocated for investment-oriented activity. The trend highlights the changing role of the Government's budget in allocating national resources. The higher tax burdens and rising debt in recent decades effectively have financed a gradually declining amount of real Government purchases. Thus, the Government's direct absorption of national resources is shrinking. At the same time, a sharply rising amount of real transfer payments distributed primarily through entitlement programs is directly financing consumption by their beneficiaries. These programs are the source of any array of economic distortions that suppress growth. In terms of public perception as well as economic performance, this increasingly distributional role of the Federal budget is as important as the magnitude of deficit spending: witness the many households that are not direct beneficiaries of transfer payments who claim they are paying higher taxes and getting less (directly) in return.

The tax bias against saving and the deficit spending for consumption-oriented entitlements generate the lowest rate of saving among major industrialized nations. National saving is 33 percent of GDP in Japan, 20 percent in Germany, 19 percent in France, and only 14 percent in the United States. The United States also has one of the lowest investment rates among industrialized nations; gross fixed investment is 13 percent of GDP in the United States, substantially less than the 31 percent in Japan, 23 percent in Germany, and 21 percent in France. The wide gap between national savings and investment causes the huge current account deficit which must be financed by international capital flows.

It is noteworthy that the U.S. budget deficit of 2.3 percent of GDP is only a small portion of the shortfall of U.S. saving compared to other industrialized nations. This underlines the fact that the budget and current account imbalances are more than arithmetic and illustrate the misguided nature of the "twin deficit" paradigm that was so popular in the 1980's, instead, these imbalances reflect the distorting economic impacts of the spending programs and the tax structure on national saving and investment. Thus, contrary to common perception, simply reducing the budget deficit does not necessarily reduce the current account imbalance; the outcome depends on how the deficit reduction impacts national saving and investment. Witness the Clinton administration's 1993 deficit cutting package; it cut the budget deficit, but by relying so much on tax increases, it failed to achieve one of its primary objectives of shrinking the current account deficit because the reduced Government dis-saving was largely offset by lower private sector saving, leaving national saving virtually unchanged. The result was simply a wealth redistribution from the private to the public sector. Attempts to reduce the trade and current account imbalances through trade negotiations, without shrinking the gap between national saving and investment, are similarly fruitless. Lowering the current account (and trade) deficit requires a credible reduction (or reallocation) of Government spending and/or tax reform that raises net national saving. A reduction in the current account (and trade) deficit may or may not raise the U.S. dollar; the outcome depends on whether or not these changes enhance expected rates of return on dollar denominated assets.

The change in the mix of deficit spending toward consumption-oriented entitlements at the expense of investment-oriented activities generates a wide array of distortions and disincentives; the structure of many transfer payment programs discourages work, a fact well understood in the current Congress, while medicare, medicaid, and associated tax incentives have raised the demand and provision of medical services. The high taxes on labor reduces labor supply and constrains real wage growth. The list goes on. Suppressing saving and allocating national resources away from investment lowers long-run economic growth and standards of living. Some argue that the U.S. Federal tax burden is lower than in other industrialized nations, and its social welfare subsidies less. They are. But the economic burdens of following misguided policy benchmarks are enormous; witness the dismal economic performance and double-digit unemployment rates throughout Europe.

Achieving fiscal responsibility and credibility necessarily requires slowing the spending growth for nonmeans-tested entitlements by changing the structure of key programs consistent with announced deficit targets. The deficit targets are of secondary importance to enacting the required programmatic changes. Because open-minded entitlements comprise such a large and rising portion of outlays, their growth must be slowed through changes in their structures. Medicare reform must involve incentives that reduce the demand for unnecessary medical services and improve the efficiency of their provision, and not rely on Government-determined spending caps and price controls. Medicaid reform must encourage competition among providers while meeting the reasonable needs of patients; this likely involves transforming the program from a Federally managed, open-ended entitlement to a decentralized program funded by flexible block grants from the Federal Government. Welfare reform must include financial incentives to work.

Deficit targets without programmatic changes are bound to fail and only reduce fiscal credibility. Insofar as outlays for entitlement programs are affected by demographic trends, economic performance, inflation, and other factors, actual spending may deviate from projections. Therefore, it is the legislated reforms designed to achieve savings, eliminate structural flaws, and introduce economic incentives and efficiencies into these programs, rather than deficit targets, that are crucially important to fiscal responsibility. The rough deficit targets provide only a framework for evaluating the types of programmatic changes.

In this regard, the Federal debt ceiling is not an effective mechanism for achieving fiscal responsibility and is logically inconsistent with the open-ended entitlement programs that are the source of the deficit spending and rising debt. The fiscal debate should be disentangled from the legal debt ceiling, and the latter should be abolished.

Economic Impact of Deficit Reduction. A credible deficit-cutting package based primarily on slowing spending growth in nonmeans-tested entitlements would not significantly depress cyclical economic activity in the short run, contrary to standard demand-driven macroeconomic models, and would be positive for long-run growth. The positive impact on long-run economic growth is widely recognized; although estimates are uncertain, the cumulative rise in standards of living is substantial. The debate about the short-run effect of deficit reduction is biased by standard macromodels that incorrectly rely nearly exclusively on deficits to measure fiscal thrust—and assume that all deficit reduction reduces national wealth and is restrictive—while largely ignoring the mix of deficit reduction and the potential positive impact of enhanced credibility.

A cut in transfer payments, unlike a reduction in government purchases, would only redistribute wealth, so its largest impact would be to change the mix of economic output, rather than dampen the aggregate level. Temporarily, consumption and medical services output would be reduced, as the disposable incomes of beneficiaries are reduced by the slower growth in transfers. However, the change in the allocation of national resources and lower interest rates would raise national wealth, generating stronger growth in investment, healthier housing activity, and a reduction in the net export deficit. Reduction of current economic disincentives and heightened credibility would limit short-run disruptions.

In fact, failing to achieve deficit compromise has been costly. The extended period of delay, Government shutdown, and uncertainty has contributed to the backup in interest rates and the weakness in economic activity. Perhaps most importantly, by delaying inevitable fiscal reform and thereby raising its eventual costs, fiscal policymakers' credibility has diminished further.

Social Security Reform is Necessary. Failure to include social security in the fiscal debate is a glaring omission; it only raises the eventual costs and distortions of the program, increases the magnitude of the corrective actions that eventually will be required to ensure financial stability of the program, and exerts a high cost on all other spending programs. Outlays for social security continue to rise rapidly

and will remain a major factor contributing to the increase in future Federal spending. Its benefits and taxing structures discourage work and generate significant distortions in labor markets. It generates arbitrary and undesirable redistributions of wealth. And despite its size, social security fails to address the financial needs of certain pockets of elderly, while being overly generous to others. It is widely recognized that corrective action is necessary to ensure social security's long-run financial stability, and that change must be implemented with long leads to be fair and allow older workers time to plan for retirement. Excluding social security from the fiscal bargaining table only raises the eventual costs of reform and forces policymakers to extract larger savings from the remaining programs.

Adjusting the COLAs. An obvious component of a fiscally responsible deficit-cutting package is adjusting the cost of living adjustments (COLAs) on entitlement programs to reflect the CPI's overstatement of inflation. There is widespread agreement that the CPI overstates inflation, but some uncertainty about the magnitude. It has been estimated that the overindexation of social security alone has cumulatively raised Federal debt \$200 billion. In fiscal year 1995, spending on Government programs indexed for inflation constituted over \$450 billion, nearly one-third of total Government outlays. Not surprisingly, these programs have been some of the fastest growing, and their shares of Federal outlays and GDP are projected to continue to rise. Not only is the inflation measurement bias extremely costly, and threatening the long-run financial stability of social security and other public retirement programs, it also generates unintended, arbitrary wealth redistributions. It increases the real purchasing power of beneficiaries while taxpayers may be incurring declining real wages, and accentuates the redistribution of wealth from future generations to current retirees.

Adjusting the COLAs on retirement programs by 0.5 percentage points below CPI inflation would save over \$100 billion over the 7 year projection period (the savings would be cumulative). This adjustment would be well within estimates of the CPI's inflation bias and would be efficient and fair. Again, delaying this adjustment only raises the magnitude of future reform required and reduces the flexibility to compromise.

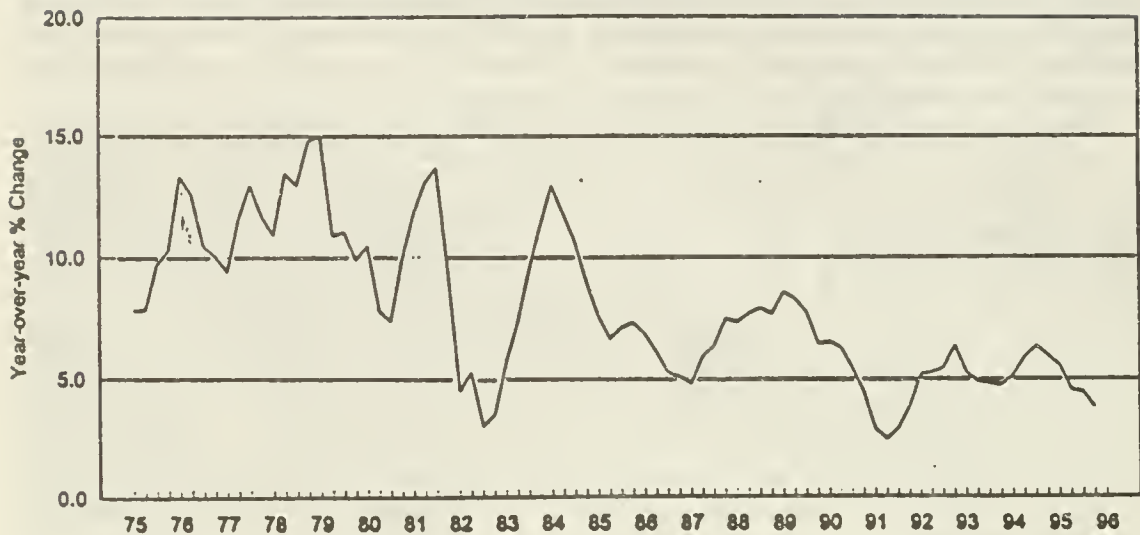
Tax Reform. Tax reform should focus on the tax bias against saving that contributes to the long-run problem of the low rate of national saving, and avoid temporary tax cuts that only fuel consumption. The tax cut proposals included in Congress's and the Administration's recent budget plans are not tax reform. Providing tax credits for child education effectively subsidizes investment in human capital, a desirable objective, while adjusting capital gains taxation for inflation is also desirable. However, Congress must avoid politically motivated, temporary tax cuts. They dilute the deficit impact of proposed spending cuts, tend to accentuate the current fiscal policy bias in favor of consumption, and do little to raise long-run standards of living. Optimally, tax reform should seek to simplify the current system and adopt a stable, predictable tax code that eliminates undesirable distortions, including the biases against work, saving and investment. Incremental changes must not divert attention from the need for true reform. A cash-flow, consumption-based tax with a graduated, progressive rate structure and appropriate exclusions for low-income households holds the most promise.

An End-Note on Monetary Policy. The Federal Reserve's monetary policy cannot offset the economic effects of irresponsible fiscal policy; they are very different instruments with different economic effects, and are not substitutable. Fiscal policy determines the allocation of national resources between the public and private sector and influences long-run potential output by altering incentives to consume, save and invest. Fiscal policy is not capable of generating a permanent shift in aggregate demand. Accommodative monetary policy is incapable of enhancing long-run productivity or output, and only generates higher inflation that interrupts economic expansion. Attempts to change the policy mix to achieve a desired level of economic output require that the magnitude and timing of the economic responses to fiscal and monetary policies be well understood; they are not. I encourage Congress to pursue fiscal reform in an attempt to create an environment conducive to sustained economic growth, job creation, and rising standards of living, and simply note that its efforts necessarily must be conducted independently of the Fed's monetary policy.

Chart 2

Nominal Spending Decelerates

Nominal GDP



Growth Patterns During Expansions

	Annualized Growth From Recession Trough:				
	<u>91:Q2</u>	<u>82:Q4</u>	<u>75:Q2</u>	<u>71:Q1</u>	<u>61:Q1</u>
Real GDP	2.4	4.2	4.4	5.2	5.6
Real Disposable Income	2.4	3.5	3.9	5.6	5.5
Employment	1.6	2.8	3.5	3.3	2.7
Productivity	1.4	2.0	1.6	3.1	4.3

Note: For each expansion, except Q1:71, the table measures annualized growth for its first 19 quarters; the 1971 expansion was only 12 quarters long.

Chairman DOMENICI. I might suggest, just from my own standpoint, while I am not so sure that when you and Dr. Baily speak of investing in infrastructure that will cause America to grow, I am not sure that I agree because of the quantity. It is not that much, so I have difficulty seeing how it would work.

But let me suggest to you I would swap for a minute a major, major entitlement reform package for more spending in some of the areas that you have spoken of and that some of the Senators on this side have. The problem is we end up getting neither. We don't get any major entitlement reform, and we end up restraining the appropriated accounts, anyway, to a great size. And I would just add for the record one observation. It is very, very easy to solve problems that exist right today. It is very, very difficult for Congress to solve problems that are creeping, that are coming at us over time. And, obviously, the entitlement growth and the deficit is that latter, not the former. We can always excuse it away temporarily, but it is the long-term that you are addressing, as I understood your testimony. Thank you.

Dr. Baily, you have the same amount of time, and we welcome you here. We have got your statement, and you have as much time as the others had to explain your views. Thank you so much.

STATEMENT OF MARTIN BAILY, MEMBER, COUNCIL OF ECONOMIC ADVISERS

Mr. BAILY. Thank you very much, Senator. It is a great pleasure to be here and have this opportunity.

The main theme of my testimony is that the U.S. economy is fundamentally sound. I agree with the previous speakers on that. I don't agree that the cyclical weakness is quite as strong as Mickey Levy indicated, but clearly the economy is undergoing two transitions at this time. First, it is moving from a phase of rapid expansion associated with the economic recovery to a phase of sustainable long-run growth. That requires a certain amount of adjustment, and is sometimes talked about as the famous soft landing. I am not sure if those airplane analogies are helpful or not, but that is what we have been looking for.

The second transition is to a smaller Federal Government associated with the reduction of the Federal budget deficit. That is obviously a key priority. We will have benefits in the long run, but it creates some adjustment concerns in the short run.

I don't need to repeat the eloquent statement that Senator Exon made pointing to many of the strengths of the current economy and its strengths over the past 3 years. I think the macroeconomic performance over the past 3 years really has been exceptional.

If you exclude the effect of Government purchases, the economy has grown at 3.2 percent a year on average over the past 3 years. The growth of 8 million jobs, the lowering of inflation, Senator Exon mentioned all of those things. I think I would add two items to his list. One is that we have had very strong investment, which is the basis for increased long-term growth. And we have also had a great expansion of exports. International trade is an important element in the growth and efficiency of this economy. Expansion of exports and the jobs created by these exports has been an important achievement.

As the economy entered its new phase—that is, the transition from a recovery economy to a longer-term sustainable growth rate—interest rates were increased in 1994 and early 1995 in an attempt to restrain the demand pressures in the economy. As a result, the pace of monthly job creation moderated.

The soundness of the economy comes from the fact that expectations of inflation are down, inventories have been worked down, and the net worth of households is in a strong position and can support continued gains in consumption. Long-term interest rates, despite their recent small upward movement, are well below their levels of a year ago, signaling that the market sees likely progress in getting the budget in balance and is not afraid of higher inflation.

And let me just say as an aside that I respect Mr. Capra. He is coming from the financial markets. But I think it is unfortunate if he is correct in describing the perception of financial markets concerning the prospects for budget deficit reduction. The President is putting out a 7-year balanced budget. Indeed, there is now a bipar-

tisan consensus that we are going to balance the budget in 7 years. So, if Wall Street doesn't believe that that is going to happen, that is too bad. I think it will happen.

But going back to the cyclical situation, our analysis concludes that the deceleration in the fourth quarter of growth in the economy is directly traceable to the transition problems that I mentioned. Real private final sales, a figure that excludes the effect of inventories and Government purchases, grew at a healthy 3 percent annual rate in the fourth quarter, according to the official figures, showing that private demand remains strong despite the small number for GDP growth in that quarter.

Turning to the budget deficit, as I mentioned, this reduction in the budget deficit has been a central part of the Administration's macroeconomic strategy. The deficit has come down from \$290 billion to \$165 billion; as a percent of GDP, the deficit has been cut by more than half from the level of 1992.

I think I probably don't have to say too much to this group about the importance of balancing the budget. It reduces real interest rates and gives more room for private investment. And I had some slight disagreement with, earlier remarks made about the current account. If think if we are able to reduce the deficit, plus the fact that the baby boomers are now beginning to save more, that should give a substantial reduction in the current account deficit in the next few years. In fact, there was some improvement in the current account deficit in the second half of 1995. We hope that continues. We certainly expect to see improvement there in the years to come.

Deficit reduction obviously is an important part of the Administration's strategy for improving growth, but it is only one of the elements in that pro-growth strategy. The others are to increase investment in education and technology, expand foreign markets, and to make the Government more efficient. Those are talked about more extensively in my written testimony, and I won't go into much detail here.

But let me stress that this Administration is committed to policies that promote higher long-term growth. For budget purposes, for forecasting purposes, we have to be conservative in what we project for long-term growth. But that we are in favor of policies; and are hopeful of the success of policies, that will raise long-term growth higher than our projections.

As well as those long-term strategies, we also have to be concerned with some short-term issues, and those too were raised by Senator Exxon and Mickey Levy. We do have a substantial amount of job displacement. That is an issue that is currently getting a lot of publicity. It is obviously an area where the Administration has concern. Job displacement is extremely costly to those who lose their jobs. Many of them are not able to find new jobs or are not able to find new jobs quickly. Those that do find new jobs often have to accept incomes that are lower than they received in their previous jobs.

That points to the need for policies to address job transitions—transitions which are inevitable in a changing market economy. We need policies that help workers to get the skills they need to make the transitions to new, better-paying jobs, and we need to make sure that the investment is there—again, that goes to deficit reduc-

tion—so that business has the opportunity to invest and create the jobs that are needed.

Another reason why American workers are feeling less secure is because of the slow growth of wages and incomes over the last 20 years. And not only have wages and incomes grown more slowly, but the distribution of income gains has become markedly unequal.

An article in *Business Week* notes this week that there are some signs that this problem both on displacement and on wages, but certainly on wages, may be beginning to turn around. We are beginning to see some indicators showing an uptick. This is very encouraging. Certainly we look for that and hope for that to continue.

Clearly, though, we need policies that will give workers the wherewithal to earn higher wages. That is the name of the game, to get higher living standards and higher real wages. That needs to be done in a non-inflationary way. The Administration supports training vouchers to workers who have lost their jobs, one-stop career centers to help workers have access to critical information.

It is also the case—indeed, one of the sort of good-news elements in the overall story of widening inequality—is that the returns to education have gone up. One doesn't like to see widening inequality, but one is encouraged to see that having an education is now a better investment than it was before. If we can increase the number of workers who have access to college degrees or to even a year of extra schooling, that will have a substantial effect on their earnings. So this Administration is committed to student loan programs, Pell grants, and other measures that will allow more of our workers to have access to education. Education and training clearly are key elements in both improving overall living standards and in trying to reduce the extent of wage inequality to make sure everyone shares in the overall growth.

To conclude, overall the American economy is sound, and the aggregate growth and job creation will remain steady, and interest rates and inflation should remain low. At the same time, our economic performance will continue to be affected by the transition from a phase of recovery to a phase of steady-state growth and also the downsizing of the Federal Government.

Balancing the budget is a vital step towards improving the health of the economy. The Administration is committed to a pro-growth agenda that will address our long-term economic challenges. While we must focus on the long-term strategy, we cannot ignore those who are confronting the problems of today.

Thank you.

Chairman DOMENICI. Thank you very much.

[The prepared statement of Mr. Baily follows:]

PREPARED STATEMENT OF MR. MARTIN NEIL BAILY, MEMBER, COUNCIL OF ECONOMIC ADVISERS

It is a pleasure to appear before the Budget Committee today. The primary theme of my testimony is that the United States economy is fundamentally sound, but at the same time it is undergoing two transitions. First, the economy is continuing to move from a rapid-expansion phase of economic recovery to a phase of sustainable long-run economic growth; and, second, the economy is adjusting to the transition from a larger to a smaller Federal Government, as we reduce our Federal budget deficit. Making these two transitions was necessary, but has imposed some short-run costs on individuals and companies.

In my testimony today, I will describe the state of our economy and the effect of these transitions, including the economic impact of deficit reduction. I will then discuss this Administration's strategy for promoting higher long-term growth and a healthier economy. And then, finally, I will address the reasons why many American workers are still feeling less secure about their economic futures and the measures the Administration supports to address these concerns.

Let me begin with our current economic situation.

The State of the Economy

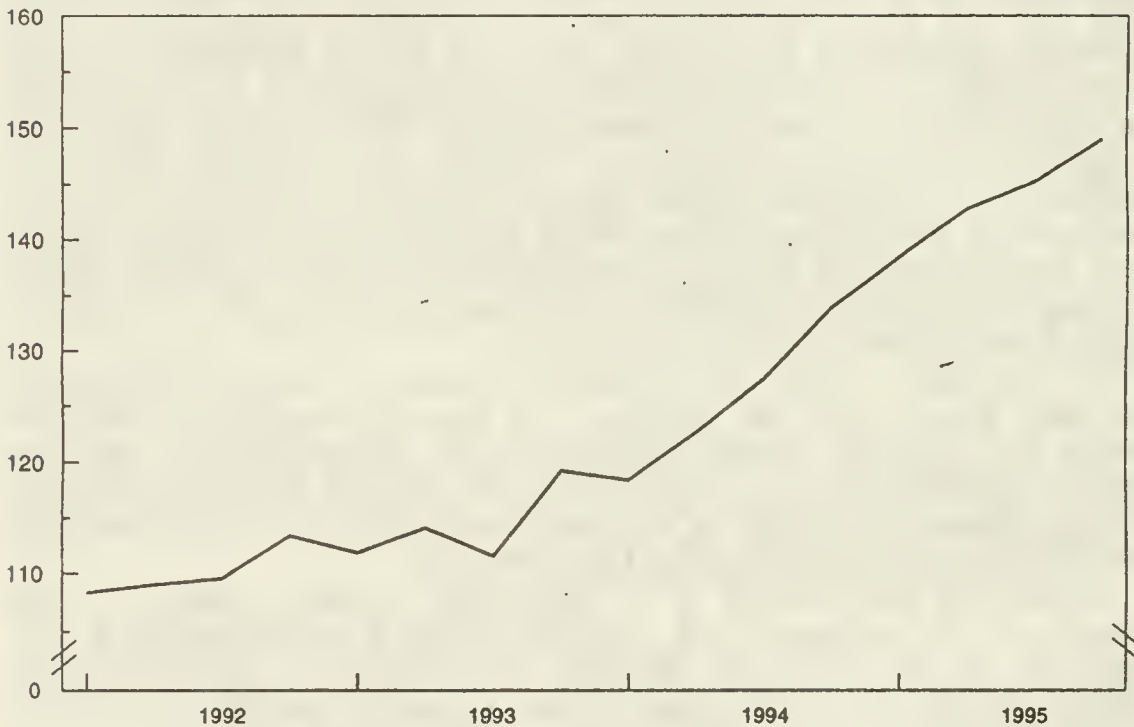
Macroeconomic performance during the past 3 years has been exceptional. Excluding government purchases, the economy has grown at 3.2 percent a year on average. Nearly 8 million new jobs have been created—roughly 93 percent of these jobs are in the private sector. The unemployment rate has declined, averaging only 5.6 percent in 1995. Long-term interest rates have declined and remain relatively low. Inflation—at its lowest average level since the Kennedy administration—is no longer the factor it once was in economic decisions.

And, export growth has been extraordinary. U.S. exports of goods have expanded in nominal terms by over 30 percent in the last 3 years. [chart 1] This is despite the fact that Mexico (one of our largest trading partners) suffered an economic crisis, and Japan's economy remained extremely weak.

Chart 1. Merchandise Exports

Goods exports have grown by over 30 percent in the last three years.

Billions of dollars



Note: Balance of Payments basis.

Over the last year, our economy entered a new phase: moving from recovery to a phase of sustained growth. During 1993 and 1994, the economy was recovering from recession and growing fast enough to lower the unemployment rate. By late 1994, the economy was operating near fill capacity and over the course of 1994 and early 1995, short-term interest rates were increased to restrain demand pressures and hold growth close to its long-run potential.

A moderation in the pace of monthly job creation accompanied the economy's move from economic recovery to sustained economic expansion. Following a strong fourth quarter of 1994, job gains in 1995 remained solid in the first quarter, slowed in the second, and then averaged 138,000 per month during the third and fourth quarters of 1995—a moderate pace of job growth.

During 1995, the unemployment rate remained roughly constant, averaging 5.6 percent. The economy managed to create enough jobs not only to replace those jobs

lost as a result of corporate restructuring, but also to provide employment for new entrants.

As Americans benefitted from economic recovery they were able to buy more goods, and they bought some of those goods from overseas. And, with foreign economies weaker than ours, the trade deficit widened. However, there were clear signs of improvement in the trade deficit in the second half of 1995, as export growth exceeded import growth and the trade deficit declined.

Like most other economists, I believe that once you adjust for the short-run effects of the business cycle, the U.S. trade deficit problem that emerged in the 1980's has been caused by the Federal budget deficit and the low rate of personal savings. With the current resolve to eliminate the budget deficit and an increase in savings as baby-boomers eye their retirement, we can expect to see improvement in the trade deficit in coming years.

Business equipment investment growth has been one of the strong points of this recovery. We experienced double digit rates of investment growth in 1993 (11 percent), 1994 (13 percent), and 1995 (11 percent). With further deficit reduction creating room for more investment, we expect strong capital formation to continue in 1996 and beyond.

Inflation remains remarkably low and stable during 1995. The consumer price index (CPI) increased by only 2.5 percent over the 12 months of 1995—down 0.2 percentage point from its year-earlier pace. Inflation as measured by the CPI has now run at less than 3 percent per year for the past 4 years—for the first time since the 1960's. This impressive record suggests that a regime change has taken place, whereby households and businesses have come to expect low inflation for the foreseeable future.

At present, our macroeconomy is fundamentally sound. Expectations of inflation are down and inventories have been worked down to a point where they are no longer a significant constraint on production. Net worth of households is in a strong position and can support continued gains in consumption. Long-term interest rates are well below their levels of a year ago—signalling that the market sees likely progress in getting the budget in balance and is not afraid of higher inflation.

But, the economy continues to be effected by the transition to a steady-state growth phase and the downsizing of the Federal Government. Real GDP is estimated to have grown at only a 0.9 percent annual rate in the fourth quarter. And, recent inventory data indicate that there may be a downward revision to this figure.

Our analysis concludes that the causes of the deceleration in fourth quarter growth are directly traceable to the problems posed by the transitions I have described above. Real private final sales—a figure that excludes the effects of inventories and government purchases—grew at a healthy 3.0 percent annual rate in the fourth quarter according to official figures, showing that private demand remains strong.

The slowdown in inventory investment at the end of 1995 pulled GDP growth down by $\frac{3}{4}$ percentage point. But, let me say: this is good news for 1996 because it means that most of the inventory correction is behind us. As we noted in the 1996 Economic Report of the President, there is a chance that our economy will hit a pothole in the first quarter of this year—caused by the severe weather in January, the lingering effects of the Government shutdown, and the transition problems mentioned above. With the drop in inventories mostly behind us, we can expect that the pothole may not be so deep in the first quarter, and the prospects for a resumption of solid growth for the remainder of 1996 are even better.

There has been some increase in consumer debt and this needs to be monitored, but its effect on the economy as a whole is eclipsed by the gains in asset values over the past year. Household net worth—the difference between assets and debt—is now at a level relative to income that rivals the highest seen in the past 30 years. Furthermore if debt were a significant problem it would show up in the level of delinquencies. The delinquency rate at a level that is historically low—although it has edged up in the past year.

Consumer sentiment—although it fell last month—remains high, at about the same range as during the mid-expansion periods of the 1960's and 1980's. Weighing all this evidence, the prospects are excellent that consumer spending will contribute to income growth in 1996 and beyond.

For budget purposes, the Administration is forecasting 2.2 percent real GDP growth in 1996 and 2.3 percent in subsequent years. These forecasts are based on the new chain-weighted index, a different measuring rod that shows slower growth than the measures used until recently. Our forecasts are reasonable and prudent and are consistent with those of private forecasters, the Federal Reserve, and the Congressional Budget Office (CBO).

To some, these growth forecasts may seem unduly modest. We believe that for budgetary purposes it is important to be on the conservative side. In fact, our record shows this: in our economic forecasts over the last 3 years, we have consistently underestimated real GDP growth and the increase in jobs, and overestimated inflation, interest rates, and the budget deficit. But, let me be clear: this Administration is committed to policies that will encourage higher long-term economic growth. These policies include: increasing national savings through deficit reduction; investing in education and technology; expanding markets, both domestically and abroad; and, making the Federal Government more efficient. I will discuss these pro-growth policies in more detail later in my testimony.

Economic Impact of Balancing the Budget

Our Nation's solid economic performance over the past 3 years has been by macro-economic policies that are conducive to sustainable economic expansion. Reducing the Federal budget deficit has been a central part of this Administration's macro-economic strategy over the past 3 years.

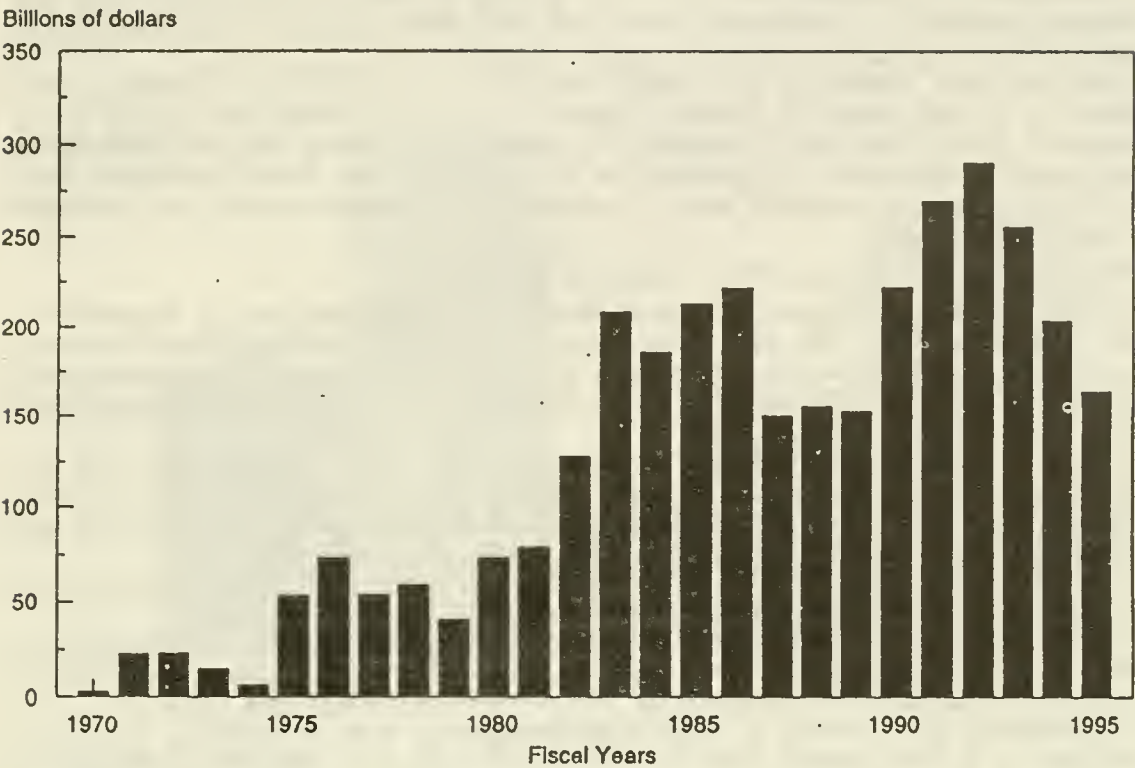
Reducing the deficit is important because government borrowing to finance budget deficits raises real interest rates, crowding out business investment that is vital for raising productivity and economic growth. And to the extent that budget deficits spill over into current account deficits, they lead to foreign borrowing or the sale of U.S. assets.

During the early 1980's, there were large and rising Federal budget deficits. The high real interest rates that resulted were in large part responsible for skewing the composition of output away from fixed investment. Private fixed investment as a share of gross domestic product (GDP) fell from over 18 percent in 1979 to under 15 percent by 1989 (to compare 2 years when the economy was operating close to capacity). The relative decline in private fixed investment net of depreciation was even sharper, from about 8 percent to about 5 percent of GDP. The effects on investment of the increase in the budget deficit likely would have been somewhat less marked if private saving over this period had risen so as to offset the decline in public savings. But, instead, both personal and business saving as a share of GDP fell over the 1980's, exacerbating the effects of deficits on interest rates and, thus, on investment.

The budget deficits and low saving rates of the 1980's also contributed to growing current account deficits that quickly transformed the United States from the world's largest creditor country into the world's largest debtor by the late 1980's. Although access to foreign capital moderated the rise in interest rates and the decline in investment, the resulting buildup in our international indebtedness means that a portion of the economy's output must be used to service the foreign debt.

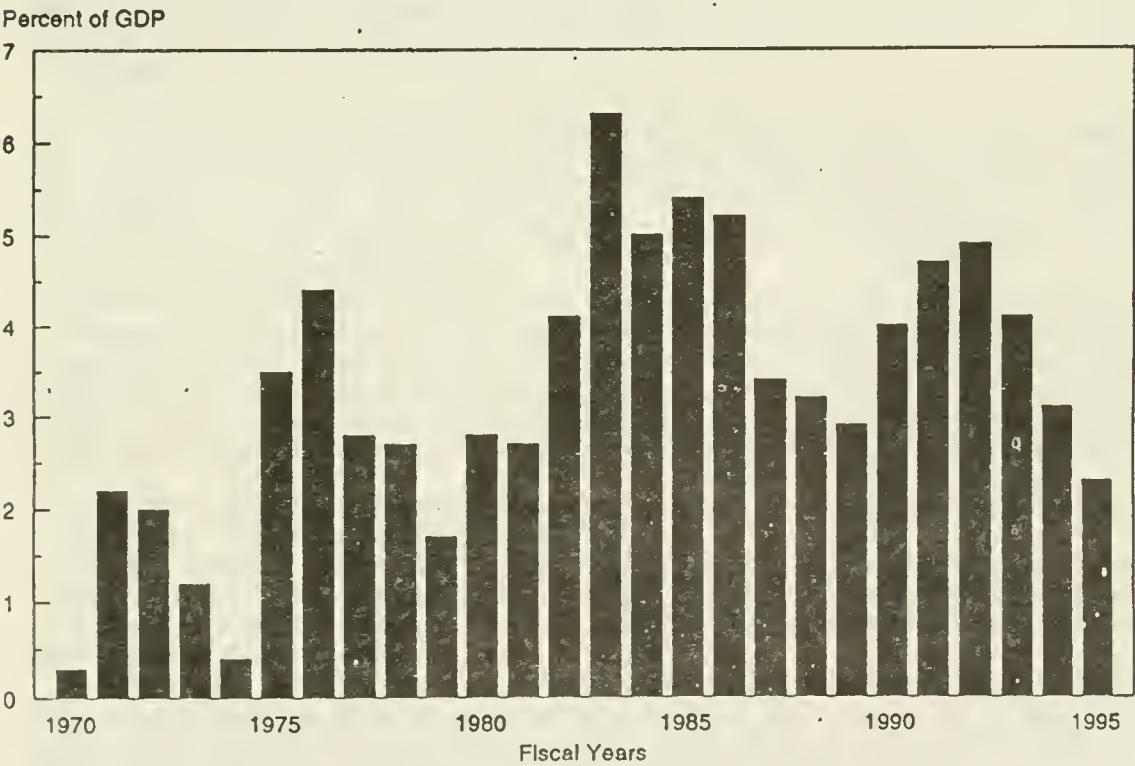
Substantial deficit reduction has already been achieved over the past 3 years—the current fiscal environment is vastly different from that of the 1980's. In the past 3 years, the Federal budget deficit was reduced from \$290 billion in fiscal year 1992 to \$164 billion in fiscal year 1995. [chart 2] As a percentage of GDP, the deficit has been cut by more than half from the level attained in 1992. [chart 3]

Chart 2. Federal Budget Deficit



Source: Office of Management and Budget.

Chart 3. Federal Budget Deficit



Note: The GDP measure used is pre-January 1996 benchmark revision.
Sources: Office of Management and Budget.

This progress in reducing the budget deficit has lowered interest rates, increased investment, and improved our competitiveness. And, it has laid a foundation for the current bipartisan consensus to eliminate the deficit by the year 2002. Further deficit reduction will enhance the climate for private investment and ensure that the economy remains on a healthier growth path over the long term, provided it is accompanied by the expected monetary policy response.

But, we must remember that deficit reduction is not an end in itself—it is a means to an end: which is stronger long-term economic growth and higher living standards for all Americans. Reducing the deficit in the wrong way—by eliminating important investments—may actually be counterproductive. Deficit reduction done the wrong way might actually lead to a slowdown in economic growth and increases in inequality.

Policies to Promote the Long-Term Health of the Economy

There are three principal sources of economic growth: increases in human capital—in the quality of the labor force through education and experience; increases in physical capital—investments in both plant and equipment and infrastructure; and increases in the efficiency with which resources are used, or the output per unit input of resources.

Using this understanding of the components of growth as a framework, this Administration has developed a pro-growth strategy that includes four important elements: increasing savings by reducing the deficit; investments in education and technology; expanding markets; and making government more efficient.

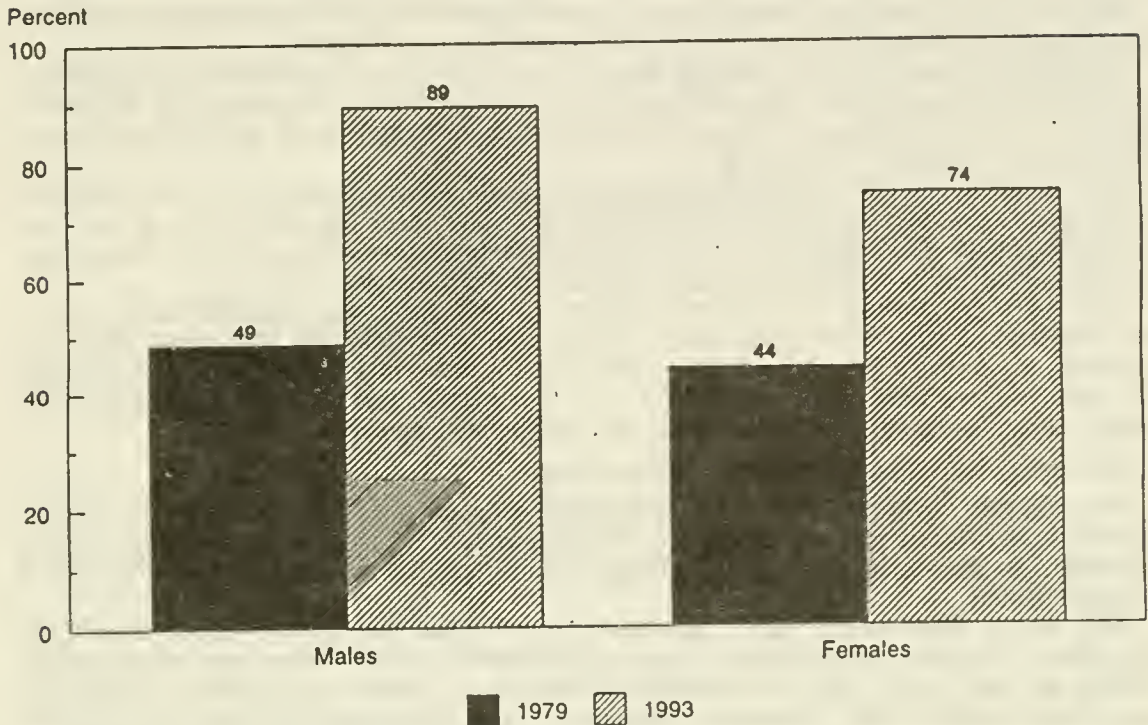
I have already discussed why deficit reduction is important to our economy, so let me turn to the other parts of this pro-growth strategy.

INVESTMENT IN EDUCATION AND TECHNOLOGY. The private sector is responsible for most of our Nation's investments. But, in certain key areas, government investments are important. One is education. The other is technology and R&D.

Investments in education are most important today than ever before. Education has become a fundamental fault-line running through the workforce. Demand for high-skilled workers is soaring, while demand for less-skilled workers is shrinking. In 1979, a full-time male worker over age 25 with at least a bachelor's degree earned 49 percent more per year than a worker with only a high school degree. By 1993, that difference had grown to 89 percent. [chart 4]

Chart 4.

Percent Difference In Annual Earnings for College and High School Graduates
Differences in mean earnings by educational attainment have widened.



Note: Data are for year-round, full-time workers, age 25 and over.
Source: Department of Labor.

Education is also an important determinant of economic growth. Between 1963 and 1992, increases in education added as much as 0.3 percentage points per year to our Nation's economic growth—meaning that education contributed about 20 percent to the growth in incomes over that 30-year period. In just the past 5 years, there is evidence that education has contributed roughly 35 percent to the growth of incomes.

Government investments can improve the quality of and ensure access to education. For instance: the government can help students from lower income families get access to higher education by guaranteeing student loans. The new direct lending program for college students provides financing for education in a less costly, less cumbersome fashion. Under the program, the government provides loans to students directly, rather than guaranteeing loans from financial intermediaries, and offers a variety of repayment schemes.

Another important growth-enhancing investment is in R&D and technology. Investments in R&D may account for half or more of the growth in output per person. These investments yield high returns—both to those that perform the R&D and to society as a whole. High social returns come from “spillovers”—that is, benefits that accrue as other researchers use new findings. But that fact is: because of these spillovers, firms will underinvest in R&D. That is why the Federal Government has to step in.

EXPANDING MARKETS. Another important part of our pro-growth agenda is opening markets—both domestically and abroad.

On the domestic front, this means reforming outdated regulations that were stifling growth and innovation in certain key sectors—such as telecommunications—and it means effectively enforcing antitrust laws to prevent unhealthy concentrations of market power.

It also means opening markets abroad. Both theory and evidence demonstrate that outward-looking trade and investment policies raise wages and living standards. Jobs supported by exports pay roughly 15 percent more than the average job. This is because exports tend to be in areas and industries where we have a comparative advantage—and, therefore, where our workers are most productive.

Since President Clinton took office, we have enacted an impressive number of trade agreements, including NAFTA, the Uruguay Round of the GATT, and a number of trade pacts with Japan. And, partly as a result of these aggressive market opening efforts, U.S. exports have grown. As I said earlier, U.S. goods exports expanded by more than 30 percent in the last 3 years.

MAKING THE FEDERAL GOVERNMENT MORE EFFICIENT. The final part of our pro-growth agenda is making the Federal Government more efficient.

Government must be a partner in growth—not a drag or a roadblock. The Clinton administration recognizes this and has attempted to make the portion of the economy over which we have control—the Federal Government—more efficient and more performance oriented.

This Administration's "Reinventing Government" effort, headed by Vice President Gore, has developed performance measures that are used for evaluation of government programs. This effort has also revised, reformed, streamlined and—where necessary—eliminated over 16,000 pages of Federal regulations.

And, as a percentage of civilian nonfarm employment, the Federal workforce is the smallest it has been since 1933—before the New Deal. At the same time our economy is so much larger and there are so many more services that we have come to expect government to provide. As a result, we have had to make government do what it does more efficiently and with relatively less resources.

Job Security and Easing Economic Transitions

The Clinton administration is committed to policies that promote long-term growth and raise living standards for all Americans. These policies are designed to address our long-term economic challenges—challenges that have been built over a 20-year period.

But, in the short-term, many Americans are feeling less secure about their jobs and their economic futures—and they are concerned about the course of transition if they do lose their jobs. To understand why some American workers are feeling less certain about their economic prospects, I will first describe some of the data on job displacement, discuss some of the long-term challenges facing American workers, and then talk about the Clinton administration's effort to help ease worker transitions in our changing economy.

JOB DISPLACEMENT. Evidence on whether the most recent wave of corporate downsizing has caused significantly more job displacement is mixed. However, job displacement may seem more prevalent in recent years because job loss has been relatively more common among white-collar workers. Bureau of Labor Statistics' data indicate that some of the workers losing their jobs in the 1991–92 recession were in industries or occupations where job stability had been the norm.

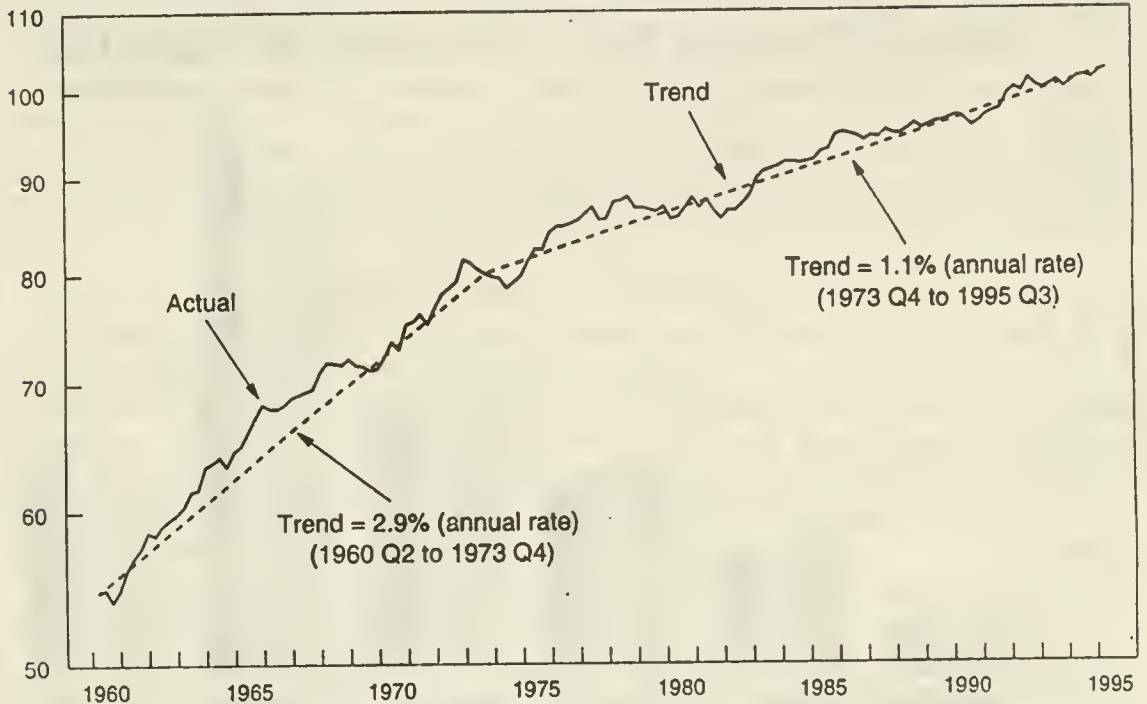
Regardless of whether there have been changes in the amount or kind of job displacement, loss of a job is both traumatic and financially costly for the average person. A BLS survey found that only 75 percent of those displaced in 1991–92 had found new jobs by February 1994. And of those that had found reemployment, the average worker suffers an earnings loss of about 10 percent. The surveys of job displacement strongly suggest the need for economic policies that cushion the financial costs of those let go and policies that speed their re-employment.

WAGES AND INEQUALITY. American workers are also feeling less secure because of the slow growth of wages and incomes over the last 20 years. The slowdown of productivity growth since the early 1970's has resulted in a decline in the growth of average compensation. Before 1973, output per worker rose 2.9 percent per year; from 1973 to the present, productivity growth has averaged only 1.1 percent. [chart 5] As a result, compensation has grown at about one-third the rate it used to. Moreover, the rising cost of health care and other fringe benefits has squeezed take-home pay in relation to total compensation.

Chart 5. Actual and Trend Labor Productivity

Smoothed for cyclical fluctuations, labor productivity has grown at a steady 1.1 percent average annual rate since 1973.

Index, 1992 = 100 (ratio scale)



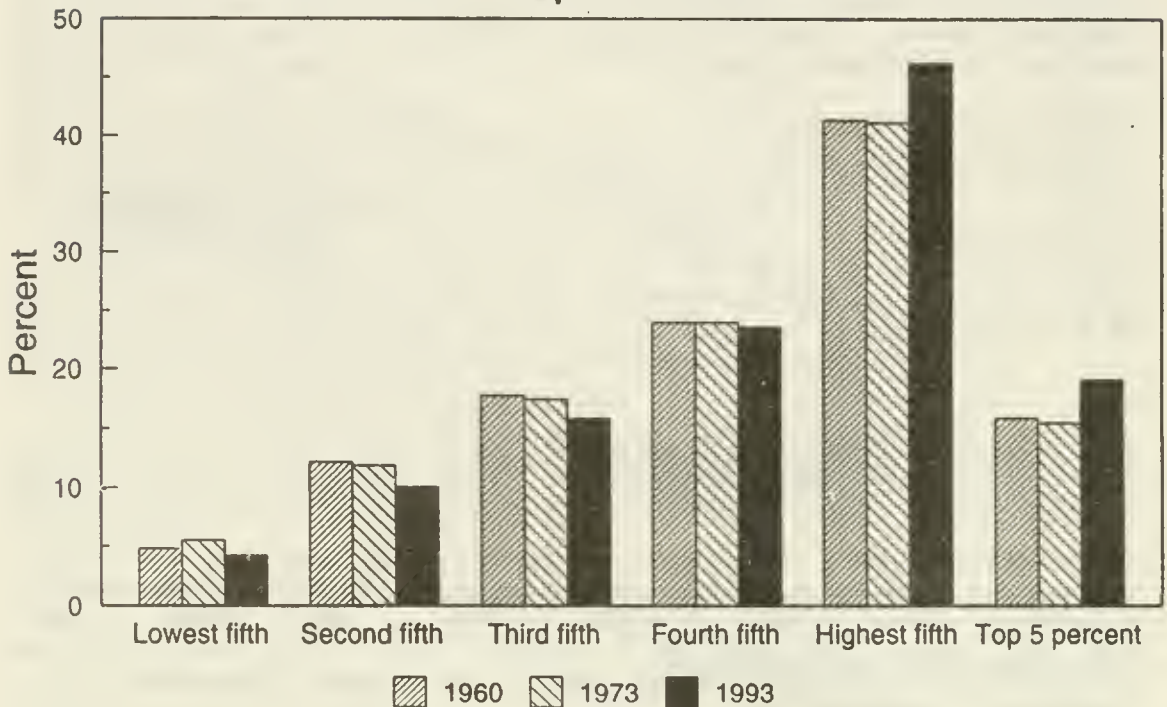
Note: Data are for the nonfarm business sector.

Source: Provisional estimates calculated by the Council of Economic Advisors from data provided by the Departments of Commerce and Labor.

Not only have wages and incomes grown more slowly over the past 20 years, the distribution of income gains has become markedly unequal. During the 1950's and 60's, all Americans saw their incomes rise in roughly the same proportions. In contrast, over the past two decades, the tide shifted. The share of aggregate income held by the top 20 percent of families increased from 41 percent in 1973 to 46 percent in 1993. At the same time, the shares of income held by the rest of America's families actually decreased during the same period. [chart 6] Some evidence suggests that the tide may now be turning. For instance, in 1994 real median family income rose for the first time since 1989. But, more needs to be done.

Chart 6.

Shares of Aggregate Income Received by Each Fifth and Top 5 Percent of Families



The Clinton administration is firmly committed to addressing these long-term economic challenges and enhancing economic security for all Americans. We recognize that one cost of a dynamic, ever-changing economy is worker displacement. From the beginning, the Administration's policy has been not to deny change, but to better equip workers to embrace it.

One important part of responding to labor market changes is employment and training policy. The Administration supports providing training vouchers to workers who have lost their jobs, helping them find a training program that best meets their needs and the needs of the workplace. The Administration also supports one-step career centers to help workers access critical information on employment opportunities.

The Administration has proposed providing more aid to workers seeking to upgrade their skills. The proposed \$10,000 tax deduction for college tuition, the Direct Lending Program and the proposed increase in the Pell Grant maximum are all examples of policies designed to help American workers to adapt to our economy's increasing demand for greater skills.

The Administration is committed to enhancing worker security by ensuring that American families will still be able to buy health insurance if they lose a job or a family member is sick; by ensuring the portability of health insurance; and, by encouraging more firms to offer their workers pensions through our pension simplification proposal.

The Administration is also committed to policies that give workers the opportunity to earn adequate incomes to support their families. For instance, in 1993, the Administration expanded the Earned Income Tax Credit (EITC) for 15 million low-income working families. The EITC is designed to help full-time wage earners raise their take-home pay to a level so that they do not have to raise their families in poverty. The Administration is committed to preserving this expansion. The Administration also supports raising the minimum wage, which this year will reach a 40-year low.

Conclusion

Overall, the American economy is sound. In the aggregate, growth and job creation will remain steady and interest rates and inflation should remain low. At the

same time, our economic performance will continue to be effected by the transition from a phase of recovery to a phase of steady-growth and by the downsizing of the Federal Government.

The American economy has an innovative and productive private sector that has generated millions of jobs. This sector will be the source of future growth in living standards for Americans. Balancing the budget is a vital step towards improving the health of the economy and making sure that the flow of new investment is available to take advantage of the dazzling new technologies that have emerged.

The Administration is committed to a pro-growth agenda that will address our long-term economic challenges. But while we must focus on the long-term strategy, we cannot ignore those who are confronting the problems of today. That is why it is important at the same time to pursue policies which address the transitions American workers are experiencing in our changing economy. These are policies that are designed to reduce uncertainty and enhance economic security for all Americans.

Thank you. I would be happy to answer any questions.

Chairman DOMENICI. Senator Exon, would you like to proceed, or do you want to go to one of your members?

Senator EXON. Well, I would like to follow the usual procedure. I believe the Senator from Illinois was here first, and when our turn comes, I would like to yield to the Senator from Illinois for the first round of questions, and then we will proceed in the usual fashion after that.

Chairman DOMENICI. All right. I yield to Senator Grassley for questions and his own observations.

Senator GRASSLEY. I want your views on the obvious that is going to happen someday, you know, because in a free economy you have recessions now and then. Is one close or not?

Chairman DOMENICI. Are you asking all of them?

Senator GRASSLEY. Yes.

Mr. CAPRA. No, I don't think so. I think the weakness in the economy now is temporary. We are already seeing some rebound off the storm- and Government shutdown-induced weakness. So my view is that we have got kind of a mid-cycle pause, very similar to Professor Baily's, which is that the economy is going through a little transition. But, no, I don't think——

Senator GRASSLEY. Not now, you mean in the next year or next 2 years——

Mr. CAPRA. I don't think recession is close right now, and, you know, most forecasters go out 18 months. And, you know, there is nothing that I see on the 12-month horizon that would suggest that there are the imbalances that would lead to a recession. Usually you have some sort of imbalances, either inflationary imbalances, external shocks. I can't predict an external shock, but barring that, no, we just don't have those types of imbalances, in my mind.

Mr. BAILY. I support that. I think that is right. I think most of the recessions that we have had in the past have been triggered by inflation building up and then interest rates go up and the economy goes into a recession. This economy just doesn't look like one with that kind of dynamic that is going to carry us into any kind of serious recession.

Mr. LEVY. I put the probability of a recession low, but primarily because of the efficiency of the business sector in reducing the potentially disruptive imbalances and the Fed's inflation-fighting credibility that has brought down rates.

At the same time, slack demand in the economy, and I don't see any pick-up in the near future. The Fed is still moderately restric-

tive. I don't expect the businesses to shift from their current cautiousness.

I believe this is more than just weather-related weakness. Last year, three of the four quarters were less than 1 percent real GDP growth, less than half of CBO's forecast, the Administration's, or the Fed's. Only the GDP bean counters on Wall Street are going to know the difference between 1 percent growth and a half percent decline.

Senator GRASSLEY. We are forecasting for the next 12 months, I believe, 2.3, 2.4 percent growth. A lot of economists you read about are suggesting that we ought to be shooting for 3 percent growth and that the Federal Government can play a very important role in shooting for 3 percent. And I don't know whether that means just the Fed being the power to accomplish that or whether that involves all segments of Government in it or whether—but, generally speaking, it is abhorring some Government policies that we are only growing at 2.3 to 2.4.

Do you think that 3 percent growth is possible? And for a sustained period of time like the golden years of the 1950's and into the 1960's?

Mr. CAPRA. My personal opinion is no. Chairman Greenspan in the Humphrey Hawkins testimony—had some interesting words to say on this that I definitely agree with. He said that we don't know for sure how fast the economy can grow without generating inflationary pressures, but he did say we had a real-life test of it in 1994, basically, when the economy grew in excess of 3 percent. You started to see some pressures in goods markets, started to see some pressures in wage costs, less so there, but you did see capacity utilization shoot up. And that suggests to him—or at least that was the conclusion I drew from the testimony, that once you start growing on more than just a recovery basis, which is what we were doing there, but trying to grow at a sustained rate in excess of, say, 3 percent, you are going to generate inflationary pressures. And when you generate those pressures, you end up with a much more cyclical situation where you may grow that way for a while, but then you are going to come crashing down in recession as inflationary pressures build.

Mr. BAILY. I think our economy could grow at 3 percent. I think it is hard to do, and certainly the recent historical evidence doesn't support the notion that we could do that easily. We achieved that in the 1950's and 1960's at a time when productivity growth was around or close to 3 percent a year in the non-farm business sector. Since 1973, productivity growth has been 1.1 percent, and it has been a remarkably stable trend. Going through various Administrations and various periods, we have had about 1.1 percent productivity growth.

That doesn't mean we couldn't go back to the old or we couldn't improve somewhat in the future, but it tells you that it is hard to do. The trend just doesn't bounce around easily with any small changes in policy or small changes overall.

The kinds of policies we have talked about that have led to greater investment, greater education and so on, those can be things that improve productivity, and we are confident that some of them

will work well. But they are not necessarily going to cut in immediately.

Let me mention a second reason why growth has been moderate, and that is that the growth in the labor force has slowed down. We have had a tremendous influx both because of the baby boom and then because of the increased participation of women. We have had a lot more workers coming into the workforce. In the past few years that trend has slowed down. The baby boom generation is now older, and the increase in women's labor force participation has flattened out.

I think one of the reasons we are not seeing extra labor force participation is because women have more young children. There are more young children at home, and I think if women choose not to enter the workforce, I think that is a choice we should respect and recognize that the slower labor force growth is a result of the choices that they are making.

So I guess one final point, and this I think goes to a point that also Chairman Greenspan has mentioned, is that we may actually be getting more growth than we are measuring, because we don't count a number of things, particularly investments. For example, we do count computer hardware; when we buy computer hardware, that is counted in GDP. It is a big part of our investment. It is a substantial part of our GDP and our GDP growth. But we don't count software investment, which is now maybe two-thirds of the total investment in information processing. So I think that is a change we need to think about in the way we measure GDP. There are a number of other changes.

Senator GRASSLEY. Dr. Baily, on that latter point, we don't legislate how those statistics are gathered. We provide the money and the bureaucracy that has the expertise to do it. If we know that those formulas aren't correct, the Administration has the authority on their own initiative to reform those statistics so that they can be more accurate. Are we proceeding to do that, then, so that we have a wise measure of the economy growing?

Mr. BAILY. There is certainly a sense in the Administration that we want and need to improve the quality of our statistical measures. I do think a little more money would help those agencies. They are getting squeezed on the budget side.

But, it clearly would be a great mistake for the Administration to start to tell the agencies how to measure the data. I think that is something we absolutely don't want to do.

Senator GRASSLEY. No; I am just saying that if there is something wrong and there is a consensus something is wrong, there is nothing wrong with saying get it right without making a political decision of adjusting the statistics. I wouldn't advocate that either. I think that would be intellectually wrong.

Let me go on to another point. Dr. Levy, you can answer my question if you want to, but I also want to give you an opportunity to comment on something. I think in your statement you took some exception to something evolving on the Hill here, and Dr. Baily made reference to tax policy that would encourage investment in employees. And I think you kind of referred to that as a bad industrial policy.

I would like to have you expand on that point that you made, because we are going to be obviously considering this legislation probably this year, particularly because it is an election year.

Dr. LEVY. I was not referring to a specific tax policy, but what I was referring to is I saw there was a conference held by, I believe, the Democratic——

Senator GRASSLEY. Yes, that is what I am referring to.

Dr. LEVY. It had some——

Senator GRASSLEY. And I assume that is what Dr. Baily was referring to.

Mr. BAILY. No. For the record, that was not what I was referring to.

Senator GRASSLEY. OK.

Dr. LEVY [continuing]. It included a few provisions that were on the right track. But those were overwhelmed by a number of others that had industrial policy written all over them in terms of the way they would force businesses to conduct business in certain ways, they would subsidize labor in ways that would cause more labor rigidities. If that total piece of legislation became law, it would make great press, but it would end up hurting precisely the people it is designed to help.

Senator GRASSLEY. OK. Dr. Baily, I assumed that you were speaking about that. You said you weren't. Does the White House back the efforts of Senator Bingaman and other Democrats to promote this concept of tax policy to encourage investment in employees? Or does the White House not support it?

Mr. BAILY. The Administration has not taken a position on the specific measures to set the tax provisions that have been described. Obviously, we think these are important issues that need to be discussed, but we are not proposing changing tax laws based on the criteria that are being proposed in that document.

Senator GRASSLEY. Oh, Dr. Levy was going to comment, I think, before I interrupted him.

Dr. LEVY. I had wanted to make a comment about your 3 percent growth.

Senator GRASSLEY. Yes.

Dr. LEVY. We face labor force growth of about 1 percent, so productivity growth of 2 percent is required to achieve 3 percent growth. The bottom line is nobody knows. However, I would underline the point that using the fixed-weight GDP numbers, productivity had been heading up, the chain weights changed that. And I would argue that I am very perplexed: Either the productivity numbers are right and the stock market is wrong, or the stock market is right and the productivity numbers are grossly understating the efficiencies that are occurring. And I would say it is a lot of the latter.

Let me give you a great example of how the productivity numbers misstate efficiency. Let's consider a large bank that lays off 10,000 employees. It takes in the same amount of deposits, makes the same amount of loans, and gets the same amount of revenues. Everybody would say, that is an increase in efficiency: Its return on assets and equity goes up, lifting the stock market prices. That shows up in the GDP accounts as a decline in GDP and no change in productivity. This is because in a lot of service-producing indus-

tries, inputs equal outputs. The bottom line is nobody knows how fast productivity is growing, but a company by company analysis in the service-producing industry and in manufacturing reveals tremendous efficiencies, combined with the decline in rates, these efficiencies explain why the stock market is up.

Regarding public policy, I think too many public policymakers, particularly the Federal Reserve, behave as if there is some ceiling on real economic growth above which inflation is generated. Real productivity-driven growth, even if it is not counted in the productivity numbers, is not inflationary. Inflation is generated by excess demand. And what I have been arguing for a couple of years now is that business efficiency and investment are raising capacity, lowering the natural rate of unemployment, while the Fed's restrictiveness is generating insufficient demand. And that is why inflation is declining. So I think there is a misread. Yours is a great question, but nobody knows the exact answer. But it is a mistake to assume that we can't achieve stronger growth, and I think policymakers are constraining their ability if they do so.

Chairman DOMENICI. The Senator from Illinois.

Senator LAUTENBERG. Mr. Chairman, if my colleague would excuse me 1 minute, I would like unanimous consent permission to put my statement in the record.

Chairman DOMENICI. Without objection. Thank you, Senator.

[The prepared statement of Senator Lautenberg follows:]

OPENING STATEMENT OF SENATOR FRANK R. LAUTENBERG

Mr. Chairman,

Finally, finally, this committee is taking a look at the economic security of American working families.

For 15 months, since the Republicans took over control of the Congress, the American people have heard nothing but the *Contract With America* and a seven year balanced budget with CBO numbers.

It is time that Congress started to focus on what the American people really care about—jobs, wages, health security and pension protection.

While the majority in Congress have been talking about cutting medicare, tax breaks for the rich, CBO numbers and glide paths, American workers have been laid off by the hundreds of thousands by some of the largest most profitable corporations in the United States.

Furthermore, those workers who are lucky enough to have jobs have seen their real wages stay stagnant for decades. In fact, the average hourly wage for a private sector worker was lower in 1995 than it was in 1965—in real terms.

Let me rephrase this.

In constant dollars, the average hourly wage was \$7.42 in 1965 compared to \$7.52 in 1965.

On top of these layoffs and wage stagnation, working families have either lost their health care coverage or have to pay more for it. They also have had their pensions cut.

Mr. Chairman, we need to shift the focus of Congress to accomplish four major goals.

First, we must enact policies that will discourage corporations from laying off thousands of workers while their profits and stock prices soar.

Second, we need to do something to increase the wages of working families in this country. A good first step would be raising the minimum wage.

Third, we need to enact legislation to protect workers' health insurance and expand coverage to those who do not have it.

When we started the health care debate 3 years ago, 37 million people were uninsured. This figure is now 41 million. We must remember that the uninsured are not slackers—84 percent of them work. We need to do something to stem this tide.

Finally, we need to do something to protect workers' pensions. Too many workers are retiring with pensions that are inadequate or witnessing their company cut back on its contribution.

The bottom line is that Congress needs to begin to debate issues that really affect American working families—jobs, wages, health security and pension protection.

The American people will really appreciate it if we focus on them for a change and not on budget esoterica!

Thank you.

Senator SIMON. And I thank you, Mr. Chairman, and, Senator Exon, I thank you for the courtesy also.

Mr. Capra, I read your written statement. I think I agree with every word in it. I can't say that very often for witnesses. I think the fact that the financial markets respond to fiscal policy is true—you mentioned some examples. In 1993 when President Clinton moved on the deficit, the same thing happened. The day after the Senate narrowly defeated the balanced budget constitutional amendment, the dollar dropped precipitously in the international markets.

My concern with the 7-year balanced budget—and I voted for that when Senator Domenici introduced it in this committee—is that legislative answers historically have not worked in terms of the final goal. When I voted for Gramm-Rudman, it had some restraining effect. But the year when we were supposed to have a balanced budget, we had a \$269 billion deficit.

The Wharton School estimates that if we have a constitutional balanced budget amendment, at the end of 7 years, the prime rate would be down 3.5 percent. Otto Eckstein's old operation, Data Resources Inc., I think was at 2 percent, and there were other variations in between.

Is your guess, Mr. Capra, that those estimates are roughly right?

Mr. CAPRA. What rate were you talking about? The prime rate, which is the short-term rate?

Senator SIMON. The prime rate, right.

Mr. CAPRA. There is no way I can really disagree. I mean, I don't have any basis for objecting. It is not unreasonable.

Senator SIMON. Dr. Baily stresses education. Part of the function of the Budget Committee is we have to make choices here where we invest our money.

Dr. Baily stresses education as something that we need to be stressing in terms of the needs in the economy. Would both of you agree on that? Mr. Capra and Dr. Levy?

Mr. CAPRA. Well, certainly. I mean, education I think is—who could be against it? I mean, I think it is clearly one of the factors that will enhance productivity and so forth. It is just at what cost. And I think the issue is what role the Federal Government needs to play in that.

Senator SIMON. Dr. Levy?

Dr. LEVY. Absolutely. But you can't just throw dollars at it. It has to be programs that provide a big bang for the buck.

The interest rate impact of a constitutional amendment to balance the budget would depend entirely on whether it is credible. You can't just pass an artificial number and go home. More importantly, you have to make the programmatic changes that are consistent with the deficit numbers.

Senator SIMON. Absolutely.

Dr. LEVY. And I think that is key.

Then I think the bottom line is, even though Jim and I work in the financial market, interest rates are going to reflect the fun-

damentals. I would much rather have high real interest rates and low inflationary expectations reflecting strong economic growth. A 3 percentage point decline in rates may reflect recession. So I would much rather have high and rising real interest rates reflecting the productivity innovations and education that raise expected real rates of return on economic performance.

Mr. BAILY. Can I make a comment on that, Senator?

Senator SIMON. Yes, Dr. Baily.

Mr. BAILY. Obviously we don't want low rates coming from recession, but I think it is helpful to have reasonably low rates associated with full employment. In the 1980's, we had very high real rates of interest as we approached full employment. If we can get to full employment with relatively lower real interest rates, that will generate more investment. It will change the economy more towards investment and less towards consumption.

Again, with due respect, Senator, I like balancing the budget. I don't like balanced budget amendments because I think they are unduly restrictive.

Senator SIMON. I understand that is the Administration's position.

What both of you—and I recognize, again, Dr. Baily, you are here as a spokesman for the Administration. But both Mr. Capra and Dr. Levy have mentioned entitlement reform. And the Chairman mentioned that in his opening remarks. Senator Conrad and I sponsored a budget alternative program that would have included a drop of 0.5 percent in the CPI.

Having a more realistic CPI, it just seems to me, is essential as we move into the future. Probably one of the most significant things I have done as a Member of Congress when I was in the House, I had an amendment adopted which called for the Administration to adjust the housing component on the CPI. If you remember the old housing component, we assumed every American bought a new home every month. And we shifted to the rental equivalency, and that has saved billions of dollars.

I think making the CPI more accurate can make a huge difference in the future, and it is absolutely essential if we are going to really balance the budget. And I do not know if you have any further comments on this in this area, but I just think this is vital.

Dr. LEVY. I would like to make a comment. It save a tremendous amount of money. Under current law, about \$450 billion in expenditures in 1995 were in programs indexed for the CPI. That redistributes wealth from a lot of workers, including low-income workers, toward the elderly, and overcompensates for their purchasing power. This is one of the reasons that constrains real wages, because employers and employees have to pay high FICA taxes to cover Social Security.

I wholeheartedly agree with you, not just from a budget point of view but from an economic efficiency and equity point of view. Like I said earlier, I am very disappointed it was not the linchpin in the budget compromise in December.

Senator SIMON. Mr. Capra?

Mr. CAPRA. Well, I think that that is one aspect of the Social Security issue that definitely should be a part of any budget change.

I mean, the fact is I have not done these numbers for awhile, and Members of Congress do not like to think in these terms.

But the fact is that if you take the present value of the contributions of, say, a retiree a couple of years ago versus his present value of his expected benefits, he makes one and a half to two times in terms of his return versus what he put in. It is a great investment. I mean, it works great. If you take the present value of my contribution or the present value of my children's contribution versus their expected present value of benefits, the numbers are like 0.7 to 0.8. I mean, basically this is a massive intergenerational transfer that is taking place within the Social Security system.

And I know it is a very difficult political football to address. Maybe, you know, the CPI is certainly one element of that, that could get us started on the road to changing this system.

Senator SIMON. Quickly, before that light changes there. We still have not worked out a 7-year agreement. If it were up—and Dr. Baily, again, I do not mean disrespect. You are part of the Administration. If I were to ask Mr. Capra and Dr. Levy, if you were to draft something in terms of what you think the National needs are, would you include a tax cut in a balanced budget proposal?

Dr. LEVY. No; It would depend on what type of tax cut. One of the major economic problems facing the Nation is the lack of national saving. If you are putting forth a tax cut that only fuels consumption in the short run and widens the gap between national saving and investment, it delays true, meaningful fiscal reform.

Senator SIMON. I agree with you. Mr. Capra?

Mr. CAPRA. I think the problems are very long-term, like these entitlement problems. And to a certain extent, to tell you the truth, the major reason why I would include a tax cut is basically to get in the direction of reducing the size of Government, especially in the entitlement area. So in some sense, it is kind of perverse. I would include a tax cut basically because you would be starving the Government for revenues and it would push you more toward reducing—it would be credible to me as an effort to reduce the size of Government, if you included the tax cut. That is probably more than anything else.

Senator SIMON. I thank all three of you. Thank you, Mr. Chairman.

Chairman DOMENICI. Dr. Levy, I was just thinking of your statement about the negative impacts of the Clinton tax increase. I thought you might consider that maybe a tax cut might be in order to offset some of the negative impacts of that.

Senator SNOWE, would you like to proceed?

Senator SNOWE. Thank you, Mr. Chairman, and I would ask unanimous consent to include my entire statement in the record.

Chairman DOMENICI. Without objection.

[The statement of Senator Snowe follows:]

OPENING STATEMENT OF SENATOR OLYMPIA J. SNOWE

Mr. Chairman, in the 1992 election season, the slogan of the day was: "It's the economy, Stupid." Well, as Yogi Berra said, "It's like *deja vu* all over again!"

Here we are, 4 years later, and the economy is once again at the top of the agenda. While the Administration has been touting "their economic recovery," American workers are talking of their "economic insecurity." They are concerned for their jobs,

their economic future, and for the future of their children. While many factors undoubtedly contribute to this feeling of economic insecurity, there is one factor that has been a continuous drag on the economy, a drag on personal income, and a drag on job creation, and that is the government's continued unwillingness to live within its means.

We've heard a great deal about the economic benefits of balancing the budget, but I don't think it hurts to restate them yet again—especially at today's hearing that focuses not only on the current state of the economy, but on the role that prudent fiscal policy can play in enhancing long-term economic prospects. By balancing the budget by the year 2002, the GAO estimates that the average American would experience a real growth in personal income of 36 percent by the year 2020. According to the CBO, our Nation's Gross Domestic Product (GDP) would increase by ½ percent and our national wealth would increase by between 60 percent and 80 percent of the cumulative reduction in the deficit. And of particular interest to borrowers, interest rates have been predicted to decline by between 2.5 and 4.0 percent according to non-partisan econometrics forecasters. These are numbers that can not be ignored.

Although it seems like a long time ago, we had a debate in the Senate last year on the Balanced Budget Amendment—an amendment that would have forced the Federal Government to come face to face with its continuing deficits. But instead of expressing his support for this crucial Amendment, and in the process most-likely supplying the needed impetus for at least one additional vote, President Clinton balked and said in effect, "We don't need an amendment to balance the budget—we can do it legislatively."

Well, despite seemingly insurmountable odds we did deliver a package that did it legislatively—and the President vetoed it. Of course there are legitimate philosophical differences on exactly how to get to a balanced budget, but make no mistake: as long as there is nothing stronger than politics or legislative "caps" to compel us to balance the budget, achieving balance and maintaining balance in the long run will be just a pipe dream. For the sake of the next generation, we must pass the Balanced Budget Amendment.

And while we continue our efforts to balance the budget despite setbacks on the Balanced Budget Amendment and the Balanced Budget Act, the latest Department of Commerce data on last year's fourth quarter economic performance points to our need for continued vigilance and concern: In the last 3 months of 1995, our GDP grew at an anemic rate of 0.9 percent—a significant backslide from the third quarter growth of 3.6 percent. And the total growth in GDP for the entire year was only 2.1 percent—a sharp drop from total 1994 growth of 3.5 percent.

In light of these less-than-stellar numbers, I find it particularly ironic that the President and his economic advisers are continuing to pat themselves on the back for a job well-done. A 12.2 percent rise in GDP since the "economic recovery" began in March, 1991, is not exactly the drawn of a new economic day for America, Mr. President. In comparison, the economic recoveries that followed the recessions of 1982 and 1975 saw growth rates of 22.6 percent over similar 57 month periods.

Besides our anemic economic growth, I am also troubled by the recent surge in long-term interest rates. Mr. Chairman, the yield on the benchmark 30-year bond has increased from 6 percent to nearly 6½ percent since mid-February alone. This increase has surprised many economists—and the explanations for the increase have been many. But many economists have cited our inability to balance the budget as a primary reason for the bond market's pessimism.

Mr. Chairman, I do not doubt that the other members of this committee share my concern for America's economic future. I therefore urge each of us to not only speak of "political will" and "moral imperatives"—but to act on these words in the weeks ahead. It is time for us to walk the walk on the issue of balancing the budget. The window of opportunity for reaching an agreement this year on a balanced budget is rapidly closing. And each week and month that goes by only makes the task more difficult and further threatens America's economic health.

I am encouraged by the efforts of a bipartisan group of 22 Senators who have been working diligently on a plan to balance the budget in 7 years, and I am hopeful that President Clinton and Members of Congress will see fit to carefully review this plan and will recognize its many strengths. It does more than the latest Administration proposal that achieves only a "paper balance" in a specific year before deficits explode in ensuing years. Our plan provides a framework for staying in balance with meaningful reforms to entitlement programs.

We cannot afford to "wait until the next election" to put ourselves on path for balance. The last election sent Washington an unequivocal message to accomplish this task in the 104th Congress and we have still not reached that goal. Why would any-

one believe that this goal will be more easily accomplished in the 105th Congress? Answer: they wouldn't.

Mr. Chairman, I look forward to the testimony of today's witnesses as we discuss the state of our economy and the impact that prudent fiscal policy will have on our future. While I remain convinced that the Balanced Budget Amendment will provide the only means of ensuring responsibility in the long-run, I am hopeful that we will yet have the political will to at least put the budget on the path toward balance before the close of this Congress. The American people are nervous and anxious—we owe it to them to do all we can in this Congress to put the economy on the right track toward the future.

Thank you, Mr. Chairman.

Senator SNOWE. Dr. Levy, I will start with you concerning a balanced budget amendment. And I would like to have you address it. I am sorry I missed your opening statement. But I would like to have you address the issue of a constitutional amendment to balance the budget in terms of the impact on the economy.

It is interesting, because I heard Dr. Baily say that it is not necessary. But a year ago, we were here discussing with great promise the idea of balancing our budget. First, we considered the constitutional amendment to balance the budget. And that, of course, failed in the Senate by one vote. Then we went forward to address the specifics of a balanced budget that would be achieved by the year 2002.

And throughout my years in the House of Representatives and now in the Senate, I have always heard that we do not need a constitutional amendment, that we can do it ourselves; we just have to put forward a specific balanced budget plan. Well, we have done that. That has obviously failed.

Would you agree or disagree with the statement that it is necessary to have a constitutional amendment to balance the budget because it enforces the discipline necessary to achieve the ultimate goal, which I think is frankly lacking. Senator Simon and I have worked on this issue in the past, even when I was in the House of Representatives and cosponsored the effort in the House and now, of course, Senator Simon has helped to lead the effort in the Senate on a constitutional amendment on a bipartisan basis.

And here we are today in 1996, and we have failed to achieve a balanced budget in reality. We do not have a constitutional amendment which would enforce the discipline that is necessary in this institution in order to make the decisions that would ultimately reach that goal.

Dr. LEVY. I am very sympathetic to your objectives. Let us consider a couple of angles, including fiscal responsibility and fiscal credibility. And if we look back at the Gramm-Rudman legislation, this was a series of artificial deficit numbers that did not include any programmatic changes.

And so when Gramm-Rudman One was violated, Gramm-Rudman Two followed. There was no teeth in it. I would be concerned about a constitutional amendment to balance the budget if it were not supported by programmatic changes. Unless you could support it with programmatic changes, it could backfire in terms of credibility.

So the answer to your question is really a political one. I guess I was very dismayed that a fiscal package was not achieved. Whether a constitutional amendment is needed to create the cor-

rect environment, I do not know. I just do not want it to backfire on you.

The deficit has come down to 2.3 percent of GDP. Excluding net interest outlays, the budget is in surplus. But to me, that is not fiscal reform. Think about the role of the budget: taxing and spending allocates and reallocates national resources. In my book, the budget is reallocating resources in a way that is adding to the National debt without increasing productive capacity.

So if you ask me about how markets and the economy would respond, everything has to do with the tax and spending proposals underlying the deficit targets. Fiscal responsibility and credibility are needed in order to get a good answer from Jim Capra on financial market responses.

Senator SNOWE. Well, the reason for a constitutional amendment, in my opinion, is because like the Governors who have constitutional provisions in their State constitutions, you cannot ignore the Constitution, which is far different than a statute that was involved with the Gramm-Rudman legislation back in the mid-1980's. I mean, I think therein lies the difference. You do not have the latitude to ignore the Constitution. You are doing so at your peril. And I think that that is the difference.

We do not have an enforcement mechanism which, in this case, would be the Constitution, and I think that that clearly would make the difference. We have heard this debate and we are here today, and we still do not have a balanced budget. And unfortunately, it is having an impact, as you have said in your testimony, Mr. Capra, as well, that it has had an impact on interest rates and rising interest rates.

And frankly, 2 percent growth or 2.5 percent growth, if we are viewing that as the high-water mark, I think that is regrettable. And when you look at 1995, when the growth rate for that year was 2.1 percent and yet three consecutive quarters of 0.9 percent, I mean, that is what is contributing to the economic anxieties of the average American. So I do not think this is economic recovery. Those who are touting it—the American people are touting the economic anxieties that they are feeling currently at this point.

I would like to have each of the panelists compare this recovery to previous recoveries. It is interesting to note that the GDP has only grown by 12.2 percent since the recovery began in March of 1991. In comparison, the economic recoveries that followed the recessions of 1982 and 1975 were 22.6 percent for the same 57-month period.

Can each of you comment in terms of what are the factors that led to, I think, a major discrepancy in terms of post-recession growth? Dr. Baily?

Mr. BAILY. Well, recovery was fairly slow after 1991. In fact, that was a period of really quite uncertain recovery and of very low job growth. We had unemployment continuing to rise. In the period 1993, 1994, 1995, the private sector of the economy has grown at 3.2 percent annually. That is a pretty good recovery. We also have got a downsizing of Government.

But, if you look at the growth in the private sector, it compares quite favorably to previous recoveries. One thing about 1982, of course, is the economy was in a very deep recession in 1982. Unem-

ployment had gone over 10 percent. We had a huge amount of excess capacity. So some more rapid growth, certainly would be expected because you just had more slack in the economy.

By the way, we have not had three consecutive slow quarters. We did have a rapid quarter in the third quarter of this year. And I think we are going to get a bounce-back of growth in the second quarter of this year. So if you look at, overall, the past 3 years, it is really a very, very favorable macroeconomic performance, both in terms of GDP growth, job growth, low inflation.

You know, you would have to go back a long way to find a period that is as favorable as this from the point of view of the macro economy. This is not to deny the anxieties that workers are feeling, much of which comes from the change going on in the private sector which is bringing about the efficiency gains that Dr. Levy pointed to. But the macroeconomic performance, I think, has been excellent.

Dr. LEVY. I take issue with some of that assessment. I wholeheartedly agree the economy is very sound. But I have a table (not part of this testimony) that measures from recession troughs the annualized growth in real GDP, real disposable income, employment and productivity. So far this expansion, real GDP growth annualized is the slowest since any expansion going back at least to 1960.

Here I will toss in a caveat. Dr. Baily is exactly right, insofar as the decline in government purchases suppressed GDP. But nevertheless, it is weak. Real disposable income, also its slowest growth annualized; employment, its slowest growth annualized; and productivity, its slowest growth annualized. But I mentioned earlier that I believe the GDP numbers on productivity really do not capture the increase in the standard of living.

But if you look at the official statistics coming out of the government—

Mr. BAILY. Since 1991.

Dr. LEVY. Yes; and I also looked since 1993, and the numbers get a touch better. But you are still below the average.

Chairman DOMENICI. What are you reading from, Doctor?

Dr. LEVY. These are official statistics, and I would be pleased to put this in them record.

Chairman DOMENICI. I would appreciate that.

[The following was subsequently submitted for the record by Dr. Levy:]

Growth Patterns During Expansions

	Annualized Growth From Recession Trough:				
	<u>81:Q2</u>	<u>82:Q4</u>	<u>75:Q2</u>	<u>71:Q1</u>	<u>61:Q1</u>
Real GDP	2.4	4.2	4.4	5.2	5.6
Real Disposable Income	2.4	3.5	3.9	5.6	5.5
Employment	1.6	2.8	3.5	3.3	2.7
Productivity	1.4	2.0	1.6	3.1	4.3

Note: For each expansion, except Q1:71, the table measures annualized growth for its first 19 quarters; the 1971 expansion was only 12 quarters long.

Dr. LEVY. Two factors are at work cyclical weakness and, as the Federal Reserve Chairman talked about, a lot of 50 mile-an-hour headwinds in 1991–1992 and a strong structure now.

Senator SNOWE. Mr. Capra?

Mr. CAPRA. I just want to comment on one aspect of this recovery in which I am not that——

Chairman DOMENICI. Would you put the mike up closer, please, Jim?

Mr. CAPRA. I want to comment on one aspect of this expansion, though, that I think has not been addressed. It might be somewhat smaller than other expansions. But one of the fascinating parts of this expansion is the investment part, because we talked about how little investment the United States does.

In the 1961 to 1969 expansion, the portion of GDP growth that was attributable to producers' durable equipment—that is investment—was 7.4 percent. In the 1970 to 1973 expansion, it was 11.3; in the 1975 to 1980 expansion, it was 11.0, 11 percent of the expansion due to producers' durable equipment; 1980 through 1981, that was a short expansion, 10 percent; 1982 through 1990, that 8-year expansion, the portion attributable to producers' durable equipment was 8.6 percent. The 1991 through 1995 expansion, a full 25 percent of that expansion is because of the expansion of producers' durable equipment, plant capacity, really, in the equipment area.

So I view that as really something to say that the balances in the economy are quite good and I would add one more thing, which is this committee is on record talking about problems with the CPI measurement and so forth. I would just raise the issue that the growth that we are talking about, these 2 percent numbers and so forth and so on, may actually be low, not because of the productivity issue and all of that—or maybe it is related to that.

But the fact is most people argue the CPI is overstated by 0.5 to 1 percent. Well, that feeds into the nominal versus real GDP mix. So internally, I actually think the economy has been expanding at a somewhat faster rate. And when the BLS changes the CPI approach, they will revise all that back.

Senator SNOWE. Thank you. Thank you, Mr. Chairman.

Chairman DOMENICI. Senator Conrad?

Senator CONRAD. Just to put in perspective, I mean, I think what has happened over the last several years with respect to the economy, it has been, I would assert, a remarkable performance.

We have got the strongest overall economic growth over the last 3 years, the strongest of any industrialized country. We have got the strongest private sector economic growth than we have seen in a long time. We have got the strongest business investment growth, which Mr. Capra was referring to. That is the strongest in 30 years. Exports have grown by one-third. Job growth has been very strong, nearly eight million new jobs created. The stock market has been nothing short of spectacular. And when we look at the "misery index", the combined rate of unemployment, inflation and mortgage rates, they are at the lowest level in 27 years.

So I think, as I hear you saying it, structurally we are in a strong position, but we have got some cyclical weakness here. I think the question for us is what do we do to make things better? I mean, that is our job. What are the policies that we can pursue

that are going to strengthen economic growth, that are going to allow people to have higher wages, that are going to make our economy more competitive.

There are a group of us—Senator Snowe has been involved in this effort and there are others who are on this committee who are not present, about 20 of us on a bipartisan basis, about equally divided between Republicans and Democrats, who have come to a conclusion on a budget agreement.

And we have a significant savings out of medicare and medicaid, not at the level that was proposed by our Republican colleagues in their budget plan, but nonetheless, significant savings; welfare reform; domestic discretionary savings and what I believe to be very important for the long-term, and adjustment in the Consumer Price Index of one-half of 1 percent.

Let me just say to you that on both sides, leaders are telling us you cannot do that—you cannot do that. It is too risky politically. If we are really serious about strengthening the American economy for the long run, I would just like the judgments of each of you on how beneficial a package like the one I have described would be, that achieves balance on a unified basis in 7 years using CBO scoring and has those basic entitlement reforms as part of it.

Mr. CAPRA. Well, you certainly are not going to get any disagreement from me. I think it is extremely important. The current economic environment, in my mind, is pretty good. And as I said, the structure of the way the economy is developing is pretty good. But if there are not the changes such as in your bill or your proposal or some of the other proposals around, if those changes do not occur, I do not feel nearly so sanguine about the year 2000, 2002, 2004, when the demands for benefit payments will be such that the Congress will either have to all of a sudden just raise payroll taxes or raid the general fund of the Treasury or do something in order to meet those demands.

Changes in benefit payments, as you well know, I mean, medicare being one of them, Social Security being the other, we are really looking at this period out to 2000, 2001, 2010. If you do that on a gradual basis starting now, it is miles different than having shock medicine distributed in the year 2000, 2002 and 2005. So I mean, for the long-run health of the economy, there is no question in my mind—

Senator CONRAD. That it should be done.

Mr. CAPRA. Yes.

Senator CONRAD. That a package like this, including an adjustment to CPI, that all of us would be better off. Dr. Levy?

Mr. CAPRA. That is my opinion.

Dr. LEVY. I agree with you. One cautionary point: you correctly talk about eight million new jobs, so you should avoid being sucked into the argument of the downsizing of corporate America and support legislation that is just going to hurt people.

And I also agree that your type of package would be very, very beneficial. If you adjust the COLAs for CPI minus half a percent, another benefit is that it would be the Government's first official recognition that the CPI overstates inflation. That would be reflected in inflationary expectations and interest rates will come down.

Senator CONRAD. I will tell you, we are in an enormous struggle here. Behind the scenes, there is still discussion and negotiation on a plan. Our group continues to meet. We will be meeting this afternoon on welfare reform, to try to fill in the details of our plan. And the stronger the message that comes from people like you about the benefits of proceeding, the greater the chances we might actually do something around here.

Dr. LEVY. The frustration is everybody on both sides of the political aisle knows that something has to be done with Social Security. I worked on Capitol Hill in the 1970's, and I remember following the debate about the Social Security amendments of 1977. As soon as that legislation was passed, a few of the key legislators looked at each other and said, "This is not the end of this story. We are going to revisit it time and time again."

Everybody recognizes that in order to change an intergenerational program like Social Security, and do it fairly, it takes 10 years or 15 years, because people who are over 55 need time to adjust. You have to start somewhere and now is the time.

Senator CONRAD. Can you tell us, in your judgment, what the short-term benefits would be? I mean, when you say this would be beneficial to the economy, how quickly, if we together—the Administration, the Members of Congress—were to agree on a plan that had these elements to it, can you give us some sense of how quickly that would be translated into a benefit to the economy?

Dr. LEVY. No, I cannot precisely. But I would say traditional demand-driven macro models implicitly assert a cut in deficits constitutes a cut in national wealth and will hurt the economy are completely misguided. I think they grossly underweight the impact of fiscal responsibility and credibility on people's behavior. I would argue that your type of package, if implemented right away and with credibility, would reduce interest rates and change the mix of economic output, but certainly not hurt the economy and probably help it.

And a key point here is setting the stage for the next 10 and 20 years, and if you could make these changes that push up real growth by a 0.1 or 0.2 per year, the increase in standards of living are staggering and absolutely overwhelm any 6-month or 1-year impact.

Senator CONRAD. Dr. Baily?

Mr. BAILY. Can I comment on that?

Senator CONRAD. Yes.

Mr. BAILY. First of all, I would like to applaud the efforts that you are making. I think the kind of package you are talking about, if you can work with the Administration and look at the things that overlap and iron out the disagreements, I think clearly there is a basis for a balanced budget over 7 years.

The President is preparing—has a budget that balances over 7 years, according to CBO scoring. Alice Rivlin, this is her last budget. She has been a friend and colleague over a number of years. She is going to produce some reliable numbers and she is going to produce a budget that balances in 7 years under CBO scoring. And I think that budget should be taken very seriously. It is a budget that could really benefit the economy. So I would urge you to work

with the Administration on trying to get something out of that that can pass.

Senator CONRAD. How soon would such—in your judgment, how soon would it help, because we have got to convince our colleagues to take this kind of step? It is not an easy sell around here, and we have got to be able to say that there would be benefit from doing it.

Mr. BAILY. Well, I think the immediate effect would be on interest rates, as my colleagues on this panel have indicated. You would get some benefit in reduced interest rates, and that would help people who are wanting to buy houses and people who are investing in other forms of investment. So I think you would get some immediate benefit in interest rates.

There is a slight danger that if you are going to put a fiscal contraction in, that will have a negative effect. But I do not think, over the short run, that is going to be a major problem. And Chairman Greenspan has indicated he will have an accommodative policy to respond to that.

I think there will also be a considerable increase in optimism. I think the country would feel better. I think businesses would feel better. I think it would have a somewhat intangible effect, a beneficial effect on the whole economy if we were to get this deal done.

Senator CONRAD. Well, I thank this panel.

Chairman DOMENICI. Senator Abraham, you are next.

Senator ABRAHAM. Thank you, Mr. Chairman. Let me just follow up, Mr. Baily, with regard to the program that Senators Snowe and Conrad and others have been involved with. I guess I interpret your comments as being receptive to that approach, but it is obviously; as Senator Conrad indicated, going to be a pretty challenging effort here on Capitol Hill.

And it certainly seems to me—I mean, I guess one component of it that I guess I would like to get a sense of the Administration's viewpoint on is the 0.5 adjustment in the CPI. What is your position with respect to that component of it?

Mr. BAILY. The Administration has not at this point accepted the idea of making a 0.5 adjustment on CPI. I think there is a concern in the Administration that we do not, at this point, know how large the error is, that there are improvements that are being made, there are adjustments that have already been made and are continuing to be made in the CPI. And I think the view is, as far as possible, we would like to see those done by the technical statistical agencies like BLS that can make that sort of adjustment, as far as possible, removed from the political debate.

Senator ABRAHAM. Right.

Mr. BAILY. So we have the best deflator possible.

Senator ABRAHAM. I mean, at some point, I assume the Administration would, in response to this, try to suggest where it felt an appropriate adjustment was. Do you have any sense of when that might be forthcoming?

Mr. BAILY. Katharine Abraham, the head of BLS, has talked about changes she is going to make and she will be making some experimental indexes which will allow you to see different ways of computing the CPI. That would give us an opportunity to see

whether there should be some change in the way the index is measured or not.

She has been hurt by budget cuts, and I do not want to overdo this, but this is an area I feel strongly about, is our economic statistics. Both as a result of the shutdown and then of the cuts in statistical agencies, she is feeling the effects of that. It is going to be hard for her to come up with the best new numbers. Some data that was going to come out during the course of 1996, are now not going to be available until January, 1997.

Senator ABRAHAM. So insofar as any ability of the Administration to respond then to the proposal, the so-called Senate bipartisan proposal that will include this adjustment in the CPI, how—

Mr. BAILY. The Administration could work with the Senate on that. Things are on the table. I think the Administration wants to get a deal done, and there are different ways of doing it. At this point, the Administration is not in agreement with a 0.5 reduction.

Senator ABRAHAM. Right.

Mr. BAILY. It is concerned about whether that might—

Senator ABRAHAM. No, I understand that. I mean, do you acknowledge—and I would agree with you—that that particular issue is particularly a political issue? But it seems to me if the Administration is not going to be in a position to really render a judgment of what type of adjustment it feels is defensible for at least the remainder of this year, it just strikes me as making it more difficult.

Mr. BAILY. There are two ways you can do it. One is through change in the nature of the index itself, and that is something that BLS will do and it will have to do that on its timetable. And we can certainly urge them to move as expeditiously as possible, but we cannot strongarm the BLS for various good reasons.

A second way of dealing with it is to say we will take the existing CPI and then subtract a certain amount from that, and do that as a political decision.

Senator ABRAHAM. Right.

Mr. BAILY. That is a political decision that the Administration and Congress could agree to. And the Administration is not, at this point, at a place where it wants to agree to it. If Congress wants to propose that, that is obviously something that could be discussed.

Senator ABRAHAM. But the Administration will not be willing to propose in any way an adjustment itself until Congress has acted.

Mr. BAILY. It is not prepared at this time to propose one.

Senator ABRAHAM. I do not want to belabor that point. Let me ask you, Dr. Levy, you outlined a set of statistics here a couple of minutes ago which reflected various comparisons of the period since 1991. I think you termed it the slowest period of economic expansion since the beginning of the 1960's. Is that a fair characterization?

Dr. LEVY. Comparing this cycle from its trough uses taking the numbers at face value; that is a correct statement.

Senator ABRAHAM. And the trough was 1991; is that correct?

Dr. LEVY. Second quarter of 1991. But I will admit, I think it may actually expose some weaknesses in the aggregate economic data.

Senator ABRAHAM. The question I guess I had is to what extent—I mean, we hit, obviously, a trough in 1991. There is a difference of opinion, perhaps. But I think the economic performance in terms of growth over the last four quarters suggests certainly not the kind of economic growth anybody at the table would like to be the permanent level of growth. It is a softening, from my point of view, as well.

And you indicated in your original comments, your opening remarks here in your statement, that you felt tax increases contribute to that. And I believe that the consistent pattern here is that of tax increases. We had a tax increase as part of the 1990 budget deal. We had a second increase in taxes in 1993. I just would like you to comment on the extent, maybe more precisely, you believe that those tax hikes have contributed to both the 1991 trough, but moreover, the slowness of growth and expand maybe on your earlier statements.

Dr. LEVY. I was trying to make the simple point that the tax increases in the fall of 1990 and in 1993 did reduce deficits, but they did not improve economic performance. And I used that as a way of saying there is a right way and a wrong way to reduce the budget imbalance. And the key issue about the Government's budget is how it allocates and reallocates national resources.

I do not know any macro model in the world in which a tax increase stimulates economic growth. And let us fast forward to where we are now. Fiscal credibility and responsibility are crucial to how the financial markets respond.

If you try to close the deficit entirely by a tax increase, certainly interest rates would come down because the markets would be forecasting recession. That is bad public policy. The dollar would fall. I encourage you to take the broadest perspective and not consider just the arithmetic of the deficit, because I do not think it is the deficit, per se, that affects businesses in Michigan or households anywhere. I think it is the underlying tax and spending structures.

And that is why these budget negotiations have been so difficult, because you are actually talking about the programmatic changes and not just some artificial deficit numbers.

Senator ABRAHAM. Right. Well, the question, I guess, that leads me to, the next question, is this: It is possible, I think, to look at the deficit as a percentage of GDP and draw at least some conclusion that it is not as great a percentage as it was in the past. But the problem, it seems to me we confront, is where we would be at the current rate of spending growth if it continued for the next 10 or 15 years.

And as I understand the numbers, by the year 2010 or 2012, unless the policy changes that I think you are alluding to—I do not know the degree of detail you have gotten into, but the ones I believe you are alluding to—are in some way changed, we are talking about a situation where literally the entire revenue collections of the Federal Government would equal those programs that basically make up the entitlement package of programs plus the interest payments on the debt that would at that time be made.

Now if that was the case, it would mean there would not be a dollar available for any other spending in the Federal Government unless the dollar was printed or borrowed. What would be the con-

sequence of that, I mean, if you had to borrow at the level to sustain——

Dr. LEVY. That is, doing nothing, and not even addressing the unfunded liabilities of Social Security? Then I think you are aiming toward slower and slower potential growth and slower and slower gains in standards of living. Nobody wants that. So I am adding that fiscal reform involves not just reducing the cash flow deficit, but addressing the Government's mounting unfunded liabilities for Social Security and the other public pensions.

Senator ABRAHAM. Right. No. And I guess——

Mr. CAPRA. I think you have a good example of what would happen. I mean, obviously all these programs would not be eliminated. I mean, there would be people crying.

Senator ABRAHAM. Right.

Mr. CAPRA. So you would end up with government spending something like you find in Europe, with 40 percent of GDP, 50 percent of GDP. And you would end up with a situation—you know, the German unemployment rate was 11.1 percent. And you would end up with double digit unemployment—I think double digit unemployment—because you would have the government as such a large part of the economic activity and basically unable to move anything.

Senator ABRAHAM. Well, my only point is this. I mean, the reason I am sort of focusing on this is that during the debate we had this year, both in this committee and on the floor, we talked in terms of numbers as opposed to the underlying policies and as opposed to the long-term projections.

And, I mean, we were treated to a lot of rhetoric about how if we only could save \$89 billion in medicare, for instance, over the next 7 years, that would somehow save the Part A Trust Fund and so on. But it just seems to me that the real problem is if we do not change the policies that underlie these programs sooner rather than later, we are going to hit this wall in about 12 or 15 years, which would either result in dramatic increases in the extent of Federal Government borrowing, dramatic changes in the program in a period of time too short to really make that transition or some kind of other equal catastrophe that would be——

Mr. CAPRA. Dramatic tax increases.

Senator ABRAHAM. Yes, that would be——

Dr. LEVY. I would add the point that it is not just an arithmetic issue once.

Senator ABRAHAM. Right.

Dr. LEVY. If you try to address the unfunded liability of Social Security by simply raising FICA taxes, that will reduce long-run economic growth. And when you consider reforming medicare, you generate a completely different economic outcome if you raise premiums than if you reform the program in a way that reduces the demand for medical care.

Senator ABRAHAM. Well, that is, I guess, what I want to close on, because it seems to me that what we should draw from today's panel, Mr. Chairman, and from what we went through last year is an understanding that there is a lot more to this than just sort of getting into numbers and trying to say, well, this person is going

to spend so much next year, in 7 years, and we are going to spend more.

The question is whether or not we are capable, if we do not change these underlying policies, of addressing much broader problems in ways that it seems to me would leave you no recourse but to take a policy change late in the game that would undermine the economy in a far greater sense.

And so I guess I appreciate the panel's help on that, and thank you.

Chairman DOMENICI. Thank you very much, Senator. First, I want to thank all three of you before I inquire and take just a few minutes with each one. Dr. Baily, how long have you been in the White House?

Mr. BAILY. About a year and a half, Senator.

Chairman DOMENICI. So I assume the year and a half—you were there when the President submitted his budget last year in the normal course of events, where he sent his regular April budget up?

Mr. BAILY. I was.

Chairman DOMENICI. I assume you were there then 6 months later, 7 months later, when the President sent up a modified budget.

Mr. BAILY. Yes, I was.

Chairman DOMENICI. Now, I would really like to know, if you could tell me, what changed in the economy or elsewhere that caused the President of the United States to send a budget up in April that did not address the deficit, did not address entitlements, and then 6 months later, sent up one that allegedly got to balance, although we can argue all day whether it did or did not.

But the premise was that he ought to have a balanced budget. What happened in the economy, interest rates or macro-wise, that caused that change?

Mr. BAILY. I do not think that was the basis of it. I think that the President felt, correctly, that he had gone out in front in 1993 in reducing the deficit and all the panel members agreed that the steps that were taken did reduce the deficit. The evidence suggests it reduces the deficit.

We then had an election in 1994, and we had a change of control in both the House and the Senate. I think the President felt that further major steps in deficit reduction, we needed to see something from the Republican side as to what you felt those should be. And once those came forward, he then prepared further budgets. And we now have a budget which balances in 7 years under CBO scoring, which is what the Congress has requested.

Chairman DOMENICI. You mean, you proposed one—he has proposed one.

Mr. BAILY. He has proposed one that does that. So I think this has been a process by which we have gotten to bipartisan agreement on balancing the budget. I think that has been very helpful.

Chairman DOMENICI. Now, let me suggest that two of you—I do not think Jim has done this. But Dr. Levy and yourself have repeatedly said that in balancing the budget, it is not only important that you get the reduction in the expenditures of Government and try to match up the expenditures with the taxes in more close

alignment, but rather it depends upon where. And I think you have used the word we have to invest, make sure we are investing right. I think you said the same, Dr. Levy.

Now, let me ask you, Dr. Baily, I hear this. And I would like to submit, at least for the record, and I do not ask you necessarily to explain it, but the President's offer that he made to the negotiating team that said, "I have a balanced budget now and let us get it done." My estimate—and that is just my estimate—is that in the 7-year period, the difference between the Republican plan on appropriated accounts which makes up most of that investment area—that is education, that is science. The difference between the two plans is the astronomical amount of five-tenths of 1 percent in terms of total appropriated accounts on the domestic side.

Now I understand that 7 years is pretty vulnerable to change, but I would like to know if you have some kind of idea of what are the principal areas that you define as areas that we should invest in and invest more in because it will help the economy and help American jobs? What are they, principally? Could you tick them off for us?

Mr. BAILY. Education, technology and, I think, protecting the environment are three of the ones that the President is pointing to. One inference from what you say, Senator, is that we got pretty close to a deal, and that maybe the fact that we do not have those big differences means that we really do have, as I said earlier, the potential for a deal.

There were other differences, certainly, on medicare, medicaid and welfare. So those differences have to be closed, also, and the size of the tax cut that was proposed, that too.

Chairman DOMENICI. My statement is not intended to indicate we were fairly close. Look, from my standpoint, we should continue trying to get a deal. But the point I am making is that I would like to know—and perhaps Dr. Levy can add here a little bit—could somebody quantify these investments that we ought to be making?

I need to be convinced, because look, I am looking at such things as the following: In American education, public style, kindergarten through 12, Dr. Levy, currently the United States Government funds 6½ percent of the educational funding for kindergarten through 12. So when we speak of the United States Government's education involvement, we are speaking of something more or less from a 6½ percent portion of the total amount.

Now, I think that is right. Some people might say it is even less than six and a half. But I tell you, it has never been much over 8½ or 9 percent. Now, it seems difficult for me to understand how adding 4 or 5 or 6 percent to 6½ percent is going to have a macro impact on America's future economy and jobs. And frankly, I can do the same in the other areas that the White House regularly speaks of.

And I have great respect for you, Dr. Levy. In fact, I want to ask you some questions about business and downsizing before I leave here because I think you have a great feeling for what is going on. But I think we throw around these ideas that if we invested more here or there, it would help the economy.

And I am not adverse to it. I just do not understand how it could have that kind of effect that causes you to constantly repeat that,

that it depends on where we are going to invest it, what we are going to invest in. Could either of you or both of you just talk to that for a moment?

Dr. LEVY. I think Jim Capra hit it on the head. How can you say you do not want to spend more—how could you say you do not want better education?

Chairman DOMENICI. No, no; I did not say that.

Dr. LEVY. We all want better education. We all want better skills for the low-skilled people. The issue is how to spend properly, how to assess what type of educational and technical skills are going to be needed over the next generation.

Chairman DOMENICI. Right.

Dr. LEVY. And then how to adjust government policies to encourage the desired outcomes. When I talk about investment and the allocation of national resources toward investment rather than consumption, I am not just referring to public investment. I am referring to private investment—

Chairman DOMENICI. OK.

Dr. LEVY [contunung]. In education and skill levels. And I think the major problem—I just recently read a series of articles in the New York Times about the downsizing of America that has gotten a lot of attention.

It seems to me there are two areas of the population of the labor force that are pushing the issue. The first is the lowest quintile and the circle of poverty. There you have a real problem with education and skill levels that are already pretty well-known. There is no easy solution.

The other is this group of middle-aged people who received their high school education and went to work on the assembly line. Now they are 40 or 50 years old, laid off from work, and they find similar jobs not available, they do not have the skills necessary. That is the “downsizing.”

These are the public policy issues. It is more than just saying we need to spend more in the public investment. We have to think long and hard about what skill levels we need.

Chairman DOMENICI. I thank you for that.

Mr. BAILY. Can I respond to your question a little bit?

Chairman DOMENICI. Sure. Of course.

Mr. BAILY. I agree that it really is not a matter of throwing large amounts of money at this problem. As you point out, most of the educational spending comes at the State and local level. But the Administration believes that U.S. Government programs can provide a catalytic role and can provide an example that may change the way some of the rest of the dollars are spent and may create an environment in which more people see the returns to education and are able to get access to it.

For example, giving Pell grants to allow students to go to college; it is not a huge amount of money. But I think if workers out there know that they have a way they can go to college by taking out a loan or getting a grant, it will begin to change attitudes. And so it may not need a whole lot of money to do that.

In terms of technology, oftentimes a small R&D Program can have a huge effect. We can develop a transistor. We can develop some small item which, down the road, leads to a whole new indus-

try. And so, again, the Federal Government can play a catalytic role. We have seen some spillovers from some of the military technologies in the past which have led to the development of the computer industry and the aerospace industry. Some of that has come out of programs that did not cost a lot of money or not a huge amount of money, but helped quite a bit.

Chairman DOMENICI. I do not have any disagreement with that at all. I am one of these—in the Federal Government science role, I am a sucker for any big science program that seems to have something real visionary about it. So I am easy. I just wanted to put it in perspective with reference to the other.

Let me talk to you for a minute, Dr. Levy. This is not the end of hearings on the subject, but let me assume a couple things with you. I assume that you believe American corporations are more competitive, for the most part, today than they were 14 years ago or 12 years ago.

Dr. LEVY. Vastly.

Chairman DOMENICI. I assume that if they would have stayed as lacking in competitiveness as they were, something very bad would have happened to American workers and the American economy. Is that kind of fair?

Dr. LEVY. I think that is fair. The adjustment of real wages and unit labor costs, to the point now where U.S. unit labor costs in manufacturing are, among the G-7, the second lowest—Canada being the lowest—has mitigated the potentially large negative impact on output and the labor markets.

Chairman DOMENICI. Now, you see out there in this election—we can't quantify it yet, but obviously an issue that is growing up you have described here variously in your remarks about worker discontent, anxiety, and it has to do with downsizing or whatever we call that and job displacement that is going on in the economy. Now, obviously, from what I have read, of the 250 largest American corporations, 58 percent have grown in employment while 42 percent have less employment. Also, 80 percent of all the new jobs added in the last year come from small business, not from large business, which is very interesting from the standpoint of worker anxiety, because much of it comes from the big employers downsizing, but the growth is in the small, under 500.

Now, what would you do or what would you recommend based on your notion of where we are to offer some hope for those who are filled with anxiety and worried about corporations downsizing, unemployment that occurs with that, and the overall issue that I have just described? As an economist, what do you recommend?

Dr. LEVY. Programs that enhance education and skill levels. That is number one. You absolutely can't avoid it.

Chairman DOMENICI. Right.

Dr. LEVY. Dr. Baily suggested some kind of transition. I would say maybe, but only as a quid pro quo for other moves toward fiscal responsibility. The average duration of unemployment has stayed about the same, but there is some evidence that layoffs now seem to be due more to dismissals than voluntary leaving. In the United States, more so than any other industrialized nation, the flow of people in and out of jobs is unprecedented, and that flexibility is what will provide continued growth and job creation.

I encourage you to address the problems of the issue and avoid falling into the trap of addressing the symptoms, and making all the mistakes that are going to hurt the people they are intended to help. Jim mentioned double-digit unemployment rates in Europe; those are largely due to government-induced rigidities in the labor market.

Chairman DOMENICI. I assumed early on that the European communities were going to follow us in our deficit reduction and that we would have had a worldwide pressure on getting interest rates down, which was something we never had planned to occur when we did our deficit reduction. It seems like that is all up in the air. That makes great sense, and frankly, the reason they are going to do it is because of competitiveness. Eventually they are going to follow. If we get ours under control, they are going to know that is a plus competitively, and they are going to do the same.

But let me just follow up, and then I will come to you, Jim. You talked about education, some kind of an approach where we could re-educate and retrain. Are there any others, Dr. Levy? What about medical coverage for some period of time in between jobs? What do you think about that?

Dr. LEVY. That is part of the transition we were talking about. Transitions, have to be structured in a way that are "humane" but don't create disincentives to seek jobs. Rather than being deceived by "The Downsizing of America," recognize that employment is increasing, and the huge flow of jobs is actually a source of strength for the long run. Without labor flexibility we would have European-type double-digit unemployment. Transitions must be geared toward a true transition rather than aggravating the existing situation.

Chairman DOMENICI. Mr. Capra, do you have some answers to this, some ideas that you might want to contribute to the record here on this?

Mr. CAPRA. Well, the only point—I mean, you could say, well, obviously, maybe we should provide long-run employment for people, but I don't think that is the direction you want to go in. For example, one of the problems in Europe is that in some of these countries—people can be on unemployment for 5 years at 90 percent of their pay. So, you know, that is one of the reasons you have 10 to 11 percent unemployment rates.

I think a lot of the anxiety is on medical care, and I think we have programs in place actually already for transitioning for medical care. So my recommendation for a lot of this is this is a transition that is taking place now for the economy as a whole as well as for individuals, and the efficiencies of the market will, I think, work their way through it. That is why this economy is so strong.

Chairman DOMENICI. Dr. Baily, do you agree that it is healthy and good for America to have our corporations more competitive today than they were 10 or 12 years ago?

Mr. BAILY. Absolutely.

Chairman DOMENICI. Is it good for American workers?

Mr. BAILY. I think overall it is good for American workers. Certainly there are workers who suffer as a result of these transitions. There is no question that some get hurt along the way. I think it is something that has to be done. If you don't do it now, you are

going to do it later. But I do think, as we are saying, that the policies that can help people get re-employed in good jobs and make the transition are important. But in the end, you have to make those changes.

Chairman DOMENICI. Well, Senator Exon, I just want to state, since I didn't make an opening statement, I want to just state for the record what I perceive we ought to do and just do that very briefly. I believe we ought to balance the budget as soon as practicable and that we ought to reform the major entitlement programs as we do that. In exchange for that, I certainly wouldn't be as rigid on the appropriated accounts, which might permit some further investment. But I also would reform the Tax Code because I think it has got some great disincentives for growth. It has all over it disincentives to save and invest, and I think we ought to change the Code to encourage savings and investment. If that means throwing the one out that we got, throw it out and start over.

I think we have to create a more balanced playing field between American corporations selling their products here and foreign corporations that bring their products in here. I think we have to take a real look at the tax structure in that regard. If there is some way to impose some kind of a flat tax on all American business and those that bring services in here that will not violate GATT, I think that would be something that American workers would feel very comfortable with, and I think it can be done.

Last, but not least, obviously I would be looking for some of these things that you have been talking about that would ease us through the transition. If we can move in that direction, from my standpoint, I believe we are in for some good times. I am hopeful we can be a part of that as we move our budget deliberations.

I yield to Senator Exon. Thank you to all of you. It is very good to have you.

Senator EXON. Mr. Chairman, thank you very much, and I just want to thank this panel once again. I thanked them when I started, and I will be finishing. I thank you again. This has been a tremendously informative hearing, Mr. Chairman, and I think our guests have been among the best panels that I have ever seen for the years that I have been here addressing these problems.

I have a few questions that I would like to get into. We are talking about balancing the budget. You all emphasized you think that is very important. It seems to me that one thing that has not been mentioned here today is that one item, and I think it is a key item, but one item that I happen to know something about, having been a Governor, and that is the line-item veto to give the Chief Executive some authority and some control over the Congress, which by its very nature in representing the people has a tendency to come up—with the exception of myself, all of the other 530 Members of Congress come up with something sometime that is parochial and does something for those at home. I speak of only the others.

But don't you believe that the line-item veto, while not a solution in and of itself, is an important step in the right direction?

Mr. BAILY. Absolutely. The Administration supports that.

Senator EXON. Do you agree, Dr. Levy?

Dr. LEVY. Yes, I agree. In a sense, yes, but in a sense it doesn't add much. And actually some cross-section evidence of States indicate that those States having the line-item veto have not slowed the rate of spending, but their mix of spending has changed. I am not so sure that in practice it would be effective in creating fiscal responsibility.

Senator EXON [presiding]. I suspect, Dr. Levy, that you are a very good economist and you make very good suggestions here today that I have complimented you on. I suggest you may be seriously lacking in the political realities, than those of us who have been Governors and those of us who have been Senators. You take a very cynical approach to the proposition. I can tell you that I did not have the line-item veto the first 8 years I served as the chief executive of Nebraska. I did have it the last 4 years, and I think I used that.

The main reason that this is important, as I mentioned earlier, is that when you get into the body politic itself, you have all kinds of things that are stuck into appropriation and authorization bills that become a part of the total mix. The chief executive officer, whether that be the President or whether that be a Governor, under absence of the line-item veto has only two options, either signing the bill in toto or vetoing the bill. You could have—the chief executive officer might be in total agreement with all the spending except there is one item in there that is grossly unfair, or a number. I hope that you understand the political realities of the situation that I am trying to educate you on.

What would you do if you were the President of the United States or Governor of a State—which you have never been, I understand. What would you do if you were a Governor and there was a bill that you were totally for except one particular item of it that you thought was terribly wrong? Would you veto? Would you sign it into law? What would you do?

Dr. LEVY. Well, I would probably use the line-item veto if I had access to it.

Senator EXON. But you just said you didn't think it was very effective.

Dr. LEVY. In practice, we don't know. And if you look at the States, it has been effective at changing the mix of spending growth, but hasn't been necessarily effective in changing the rate of growth.

But one other point here. Let me say, OK, I will go along with a line-item veto. But the real problem with the Federal fiscal outlook is not the one item here or there that the President would have vetoed if he had the line item. It is Social Security and it is medicare and it is the large entitlement programs. And those are not small line items. They are big programs.

Mr. CAPRA. Could I just add one point? I am not that familiar with the exact structure of the legislation that has been suggested on the line-item veto, and I am not sure if it includes tax legislation also.

Senator EXON. Yes, it does.

Mr. CAPRA. See, that is where I think—we are talking about spending here. I think that is the area where there is some real fruitful possibilities. I mean, there are a lot of items that have been

stuck in tax bills over the years that are very special interest-oriented, they are special corporation-oriented. They created inefficiencies in the economy, and they literally—I mean, CBO publishes every year something on tax expenditures. There are hundreds of billions of dollars there, and I think a line—and Senators or Congressmen who are trying to get, you know, re-elected, they have to raise money and so forth and so on. Not yourself, of course, but others are—you know, tend to propose those, and so a line-item veto I think would make a big difference in that area, even more so than in the spending area.

Senator EXON. Well, the line-item veto is all-encompassing. I simply say that, unfortunately, we have passed a line-item veto in the House of Representatives. We have passed a line-item veto in the United States Senate. I am one of the conferees with the House on this. We are stymied by the Republican majority in the House and Senate who do not want to give—they want a line-item veto. They are all for it, except for President Clinton. And they are very much afraid, I suspect, from what I have heard, that President Clinton might use the line-item veto, Mr. Capra, for the reasons that you just cited. You know, he might veto that outrageous tax proposal that is the heart and soul, as I understand it, of the Contract With America.

So sometimes with regard to good government, some people talk about good government. They are all for a line-item veto, but not until we get a Republican President.

I would like to go into some other things with you. First, Dr. Levy, I would like to compliment you for the emphasis and to probably a lesser degree the other witnesses have made here this morning with regard to the lack of attacking the entitlement programs of the future. And I recognize and realize that that is something that we are going to have to do.

I would certainly say—and thank you for mentioning CPI. Now, others on this side of the table have talked about the fact that, yes, they offered proposals to reduce CPI by a half of 1 percent. I have opposed those proposals, not for the reason that I don't think they should be looked at and not for the reason that I compliment the Chairman of the Fed and others, though stated for what I have thought for a long time, the problem with CPI was overstated. Whatever the proposition is, the reason that I have not endorsed this piecemeal approach is that I think when and if the Congress of the United States tackles this program, the CPI, CPI adjustments have to be a key part of that.

For example, supposing, of all things, I would think we should means-test. The lower income people, the Social Security recipients making \$400 or \$500 a month obviously are in serious trouble, but some kind of means-testing with regard to the amount that is received would be in order, and while I believe that we have a solemn commitment that we made to people who are now under the system and don't believe we should make basic changes in that system, possibly with the exception of the adjustment of CPI in some areas, as we move forward in this we recognize and realize that in that 2020 to 2030 period we are going to get into big trouble. And I think that CPI adjustments, not eliminating the CPI, but we had better start telling the American people, especially those who were

receiving CPI, that as far as retirement programs in the private sector are concerned, there is no CPI. It is only in the Government sector basically that we have CPI, which spreads out, of course, into some areas in the private sector of the economy.

So I think that is very important. We should look at that.

I want to turn, if I might, to something that I addressed in my opening statement that has been referenced to a large degree here by many of the Senators who have asked you questions, and that is back to this matter of downsizing. I would like to have a little bit of explanation from you as to what is this great competitiveness advantage that we have. What is this business about competitiveness? You know, if we hadn't made changes in the last 20 years, where would we be today?

Reference was made to the G-7 nations and what they have or what they have not done. Is competitiveness in part—and if so, what part—of the continuing investment by major corporations in foreign nations, in my view primarily because they can get cheap labor over there? Is that a factor in this competitiveness that we keep talking about and patting ourselves on the back that we are becoming more competitive?

Mr. BAILY. Can I respond to that? First of all—and I wanted to say this to Senator Domenici—while I think it is clear that adjustments do need to be made, I do believe companies do need to remain competitive, I think there may sometimes be a tendency to think that just cutting employment is the way to achieve competitiveness. It is incumbent on business managers—I don't think this is something that we can necessarily do in Washington—but I think it is incumbent on business managers to make sure that they are looking at the right way to improve their own companies' operations and they are not just getting rid of people for the sake of getting rid of people.

Sometimes companies that lay off their workers find they have lost some key people and lost some key skills, and they find they have made a mistake.

But, nevertheless, with that said, I think there are going to be situations where downsizing takes place. And although the role of international competition is important and I don't want to minimize that, I think it is also the case that just national competition is making a huge difference there. When we look at the banking industry, for example, we find that commercial banks in 1993 increased their productivity over 10 percent. That is because they are learning how to operate the payment systems, the checks, and cash and all of that. They are doing that much more efficiently, and they don't need quite as many people in that activity.

If you look at financial services as a whole, it is an area of growing employment, so that jobs are being created. Unfortunately, for some people their jobs are disappearing. If you are a teller that is being replaced by an automatic teller machine, that is not foreign competition. That is technology and the fact that the payment system is becoming more efficient.

If you look in retailing, there is lots of downsizing going on there. Part of that is because growing companies like Walmart and others are building new stores and driving out some of their competitors.

So competitiveness is by no means just a matter of foreign competition. It is a matter of national competition.

There is a lot of publicity to the AT&T layoffs. AT&T I don't think is mainly affected by foreign competition—to some extent—but, it is mostly because the telecommunications industry has changed. We just passed a new telecom bill. I think it is going to bring a lot of benefits, but it does cause a restructuring of the industry. So that is an area where job growth is going to occur, but we are also going to get some downsizing.

And so, yes, I think companies have to be competitive. I think they have to do it in the right way and make sure they don't undercut their own profitability and undercut their own workers. I think they should look for ways to train workers to fill the new slots that are opening up. But I think that process has to go forward in a way that is as humane as possible.

Dr. LEVY. Dr. Baily just mentioned two industries, banking and retail, where I think there is a significant oversupply of workers and capacity. A shake-out is inevitable, and will.

You also mentioned AT&T. Every day, I hear about another company that is a "spin-off", and they do things that produces highly technical product that generates annual revenues dramatically higher than I had thought. And then I look at the amount of employment, and it is significant. And these people have skills that are really new skills in terms of the normal labor force 10, 20 years ago.

This is symptomatic of new firms creating value-added. They start small and get bigger, and they require different skills. These offset other industries plagued with over-capacity. Others face international competition. Dr. Baily mentioned the dramatic increase in exports. Unit labor costs in the United States, which were way above worldwide standards in 1980, are now dramatically below, costs in Germany and Japan.

All this adds up to a dramatic reallocation of labor that requires different types of skills. Given these characteristics, what is the proper public policy approach?

Senator EXON. Thank you. You don't have any further comment, Mr. Capra?

Mr. CAPRA. No.

Senator EXON. My last question has to do with the fact of this downsizing proposition. I have noticed that members of the panel have talked a great deal today about Wall Street's reaction to these things, Wall Street's concern about the balanced budget and all these kinds of things, how interest rates would be lower if we would balance the budget and all these good things. Generally, I agree with that.

However, when you face reality, it doesn't seem to stack up. If Wall Street were so discouraged about the fact that we haven't come to a balanced budget agreement, since it was discussed here at some length today, I happened to be one who was very much involved in that, there is such a little difference today. If you take the total savings that have been agreed to by all of the principals in the debate, you could balance the budget in 7 years. But then we start getting all broken down and things blow up because of the

difference in how much medicare is going to be cut or how much medicare is not going to be cut.

Actually, as the President has said time and time again, but I think it is not generally understood even by economists, maybe, that the President is ready to balance the budget in 7 years if we could just come to an agreement. But rather than coming to agreement, the latest information out, including the story in the Post this morning, is that it is all going to break down.

Well, I think Wall Street knows that and anticipated probably that we wouldn't reach that, unfortunately. I simply say that if Wall Street is so discouraged as some of you seem to think they are, I don't know why we set a new record again yesterday in the face of the fact that we have seemingly all but given up, the Republicans have, on coming to some kind of agreement.

The famed CEOs of the major corporations during the budget battle a month or 6 weeks ago took out an expensive ad in the Washington Post, again, saying, you know, we have to have a balanced budget amendment, but I haven't seen the CEOs run another full-page ad and say why not and why don't you endorse the proposition that the President has offered to go ahead and balance the budget. There is entirely too much politics tied up in all of these things, it seems to this Senator.

Finally, getting back to this downsizing matter once again, it seems to me that what we are really saying is that we have become more proficient, we are more productive, we have done such great things in the last few years with regard to competitiveness. I wondered whether or not that wonderful undertaking is reflected and what I talked about in my opening remarks with regard to the average person.

Now, I agree that there is a worldwide shake-up and change going on today. I must say that I still am very much concerned about the fact of jobs going overseas primarily in certain industries because there is cheap labor over there. And I just would like to say that I wonder whether or not the average person out there today, regardless of their level of education or how successful they have been, feels that they are as well off today as they were 10 years ago or 12 years ago. I think not, because I see people of all income levels, people of all education levels, being very much concerned today about job security.

It wasn't long ago that we can all remember when there was kind of a sacred trust. Labor unions were stronger at the time. I am talking about the period in the 1960's when about 52 percent of all the workers in industrial jobs in America were unionized. That is down to 13 or 14 percent. I don't know what the reason for the decline is, but I suspect job security, the management taking and rewarding loyalty, and all those things, have kind of given way to this new international situation where I think we are shipping jobs out of the country. Maybe that can't be cut off, and maybe it is the only way to go.

I would simply say that—are you concerned today or do you think this is just a matter of fact that the figures that I cited in my opening remarks regarding the disparity between those at the highest income level of the corporations and those who are the blue-collar and white-collar workers, that seems to have spread?

Wall Street seems to like that because they bid this system up higher and higher and higher. Nobody knows how high it is going to go.

Are you as economists concerned about the disparity between the high and the lower and the fact that—certainly we can all agree today that if a worker works full-time for 365 days a year at the minimum wage, there is no way they are going to work their way out of poverty.

What do you have to say about all that, gentlemen?

Mr. BAILY. Well, I think I am going to be on your side on that one, Senator.

Senator EXON. Does that mean that the others are not?

Mr. BAILY. They can speak for themselves. I don't want to speak for them. The Administration has supported an increase in the minimum wage. I think that could make a significant contribution to those at the bottom by making sure that if you have a job, that you can live out of poverty. The effect of the widening inequality among women particularly has been exacerbated by the decline in the real value of the minimum wage. Unfortunately, a lot of women work at the minimum wage, and many of them have responsibilities and children to support. So a minimum wage increase could make a significant difference to some of the people who are at the bottom of our income distribution.

Clearly the widening of the earnings distribution is a matter of concern. Some of it reflects some fairly fundamental trends in the economy. In the past, those same trends moved us towards greater equality, so—there is some hope that we will not always be widening and that the thing may stabilize or it may reverse.

The other policy that I would note that the Administration has put forward, was to expand the EITC. We should fight very hard to preserve that expansion of the EITC. That means, again, that people who work for low wages or minimum wages are able to get some tax relief and make sure they get over the poverty line.

These are hard problems. We are concerned about them. The two measures that I have given, together with the other things, in terms of improving skills, could make a significant difference.

Dr. LEVY. First, I don't think the situation is as dire as you think in terms of the average standard of living. The employment ratio is at an all-time high. Employment is growing; real disposable income is higher. Most people may not like their life-style, but they grudgingly would say they are better off in terms of the standard of living.

With regard to the extraordinary high pay of certain CEOs, I would say in some industries, in some companies, some of the CEOs who have provided huge value-added deserve it. In other companies, it is like the CEO didn't deserve the high pay.

It is an irritant, and an issue of corporate governance, but it does not address the major issue of the income disparities. The key issue is the widening wage disparities based on educational and skill levels. Attempts to cap CEO compensation do not address the problem. The real problem is raising the skill and educational levels of workers. CEO compensation is an issue for the boards of directors of the companies, not the Government.

Mr. CAPRA. Along the lines that Mickey talked about, I think this issue of pay for skilled and unskilled labor, that is really what is going—that is the real problem right now, and the unskilled labor—the fact is, you are right, I mean, you can equally substitute unskilled labor overseas in many cases for unskilled labor here. And what is the solution? Some people would argue the solution is don't allow companies to hire people overseas. I would argue the solution is that a larger and larger portion of our labor mix should be moved into the skilled category so that basically everybody can make more money and allow worldwide competition to continue so that worldwide basically everybody helps to produce more output.

That is the first point I would say, and I think that just takes time. That is just a matter of time.

The second is I agree with Mickey that the high pay for some CEOs, I mean, whether you legislate that that can't happen or what, I don't think that is really the Government's role, and as he said, it is an irritant, but I don't think it—and it makes good press, but I don't think it really addresses this skilled/unskilled labor issue.

Then the other thing I would address which isn't directly part of your question, but I would mention it, there is a tacit assumption that when—I noticed it in the Bingaman proposal: That when corporations downsize, it is for short-run benefits, and the proposal is all oriented towards the long run. OK? Think about it. That doesn't really make any sense. If a corporation takes a multibillion charge because of its downsizing and restructuring, that is not short run. That is long run. They are trying to orient themselves towards the future as to what their companies should look like in the future so they can exist in the future.

The fact that Wall Street looks past the immediate issue and prices the stock higher because the corporation has done something that is more visionary, it is the same thing you would want Wall Street to do if we could set a price on the U.S. Senate in some sense. If the U.S. Senate does something visionary, although it may entail downsizing the Government temporarily, you know, you would want Wall Street to price the value of the U.S. Senate. So I would view that as what the company is doing is not short-sighted, but is actually very far-reaching.

Senator EXON. Gentlemen, my last question—and you have been very patient, and I appreciate it. I hope you can give me a brief answer. The other G-7 nations—and I would maybe expand my question to include what we generally refer to as the industrialized world—are they going through a similar situation today with downsizing, which is another word for laying off people to try and become more “efficient”? Or is this strictly something that primarily is a manifestation of the American system and we are being hit with it today and there is a very large concern among the general public on this matter today? Are we unique or are the other industrialized nations going through something similar?

Mr. BAILY. There are differences, but there are also some broad similarities. I had occasion to do some comparisons of the United States and other countries, and I was struck by the fact that in France and Italy, for example, manufacturing employment had absolutely plummeted in the 1980's. Even in Germany, employment

had gone down in the 1970's. So at some point, if you don't make those adjustments, they begin to catch up with you.

Some of the European countries and some of the Japanese companies have postponed their adjustment. In some cases, I think they are looking for ways to retrain their workers and find new lines for them. But in others, they are now being faced with the fact that they have too many employees and they are no longer competitive.

The forces that are leading to downsizing are not unique to the United States. Those same forces are applying worldwide. Because of individual policies and differences, there are some differences in the speed with which that is occurring and exactly where it is occurring.

Senator EXON. Dr. Levy?

Dr. LEVY. I would completely agree. Also, when structural adjustments are occurring, policy mistakes may aggravate the situation. Throughout Europe, there are wide wage and income disparities between skill levels, but not as wide as in the United States. One of the ways European governments try to close that gap is through various types of subsidies. The result is to drive up the unemployment rate.

So I would say it is best to recognize this is an ongoing characteristic in the United States, and then think long and hard about the right way to address it, that is, close the wage and income differentials and raise standards of living, not lower standards of living.

Senator EXON. Mr. Capra?

Mr. CAPRA. All these countries are going through, as Dr. Bailly said, similar pressures. Their responses are different, as I said, and let's just take Japan, for example. They have a tradition of lifetime employment, so their unemployment rate moves very little.

But, on the other hand, the situation in Japan is horrendous at the moment. The country hasn't grown in several years. I will give you an example. When the U.S. stock market crashed in 1987, the Dow Jones Industrial Average went from, I don't know, 2200 down to 1600, something like that. And we know the Dow Jones is now 5600. That is not speculation. That reflects higher profitability.

The same day the U.S. stock market crashed, the Japanese stock market was sitting at 19,000. The Japanese stock market today still sits, 9 years later, at 19,000—between 19,000 and 20,000. Basically they have had little progress in 9 years, whereas, you know, our situation has been enhanced. And I would attribute—there are lots of things going on in Japan, but a good part of it the rigidity of their whole workforce structure.

Senator EXON. Gentlemen, I want to thank you very much. I said at the beginning and I will say it now: You have been very, very helpful to us. Thank you for your patience, and with that we are adjourned.

[Whereupon, at 12:54 p.m., the committee was adjourned.]

IMMIGRATION AND PUBLIC WELFARE BENEFITS

TUESDAY, MARCH 12, 1996

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Grassley, Nickles, Gorton, Abraham, Frist, Exon and Simon.

Staff present: G. William Hoagland, staff director; and Mike Ruffner, analyst for income security and veterans.

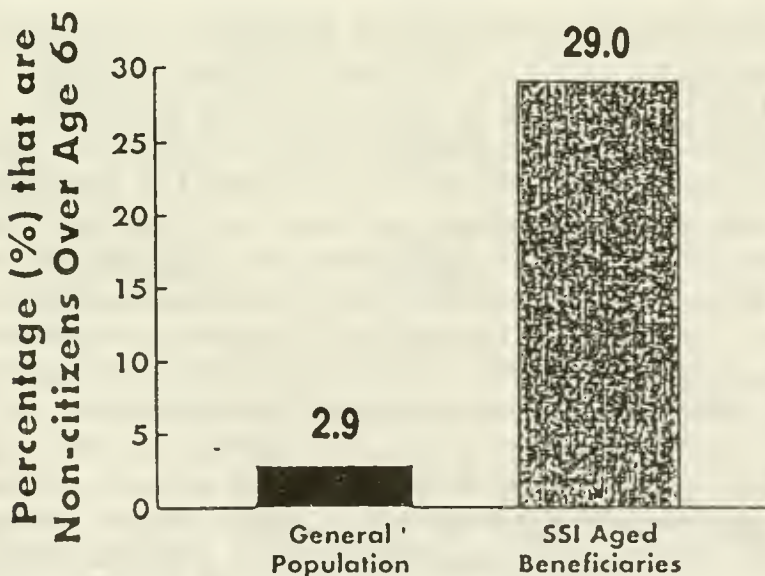
For the minority: William G. Dauster, democratic chief of staff and chief counsel; and Joan Huffer, senior analyst for income security, social security, and medicaid.

OPENING STATEMENT OF CHAIRMAN DOMENICI

Chairman DOMENICI. The hearing will come to order.

Senator Exon, I would like to show you this chart entitled, "Non-Citizens Over 65," and I will round it to "3" and "30" if you will permit me.

Non-Citizens Over 65
1992



SOURCE: Congressional Budget Office

Three percent of the population of older Americans are legal immigrants, but 30 percent of the SSI beneficiaries are legal immigrants. In other words, instead of it being this portion, something has gone awry where very huge numbers of legal immigrants are moving to SSI, and it becomes a very big budget issue. And I must say I do not want anyone to think that this Senator is one of those who are anti-immigration. I would be a fool. Both of my parents—not grandparents, but parent—came here because the farm policies of Italy would not let them make a living. So they came to New Mexico, and I guess I would not be here if Italy had not had bad farm policies, so sometimes bad agricultural policies turn out good.

In any event, there are very serious budget problems, and I might say for the record that as we negotiated with the White House, trying to get a total welfare reform bill, there was a \$13 billion difference between what we proposed and what the President proposed. In this area that we are speaking of, we thought we could save a total of \$20 billion, and the President thought we could save \$7 billion, so one of the big stumbling blocks, Senator Exon, was that difference of \$13 billion.

I thought that was worthy of our putting a little attention to it even though, obviously, there will be a big immigration bill that will address the issue.

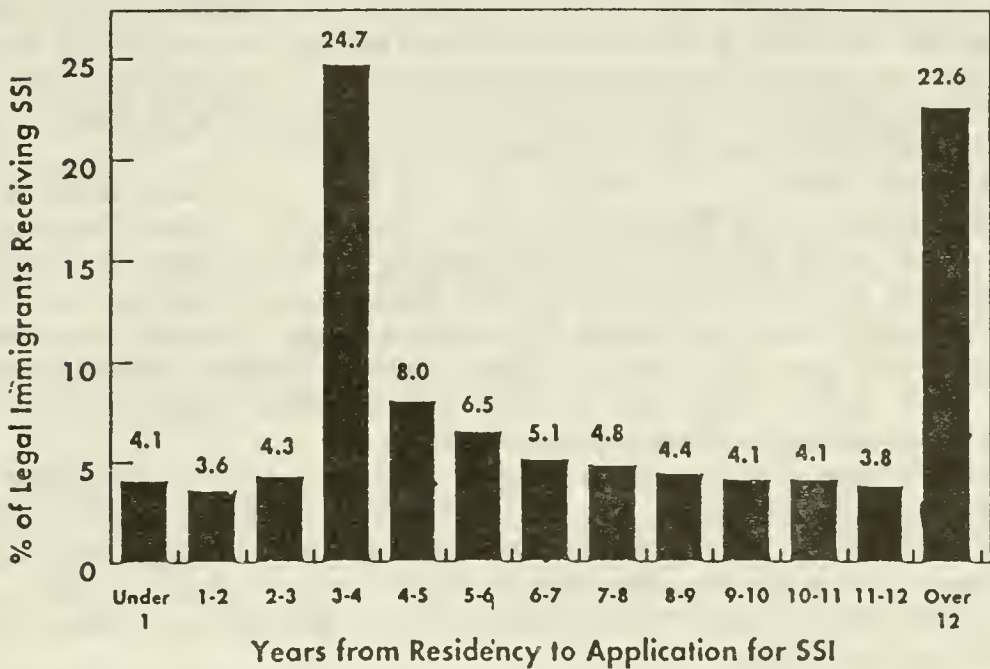
I want to make just a couple of points with reference to this, and I am sure there will be spread on the record from one or more witnesses, that the United States ought to be a generous country and that we ought to favor family reunification. And perhaps some will say that whatever the cost, that is good public policy.

I am not so sure that we should say whatever the cost. SSI 10 years ago was a \$9.3 billion program. That is a general tax-funded program. This is not Social Security. As a matter of fact, it is put in the law because it is assumed that people would not have enough time to get Social Security or would be too old. Spending on that program went to \$24 billion this year and, Senator Exon, it is projected that by the year 2000, that program will cost \$40 billion.

It is the fastest-growing Entitlement Program—and that is said about a lot of programs, but it is the fastest-growing by far.

What seems to be happening is that under the auspices of family unification, somebody living in America who is entitled to reach out and bring a relative to the United States under the American policy of family unification. Somehow or another, it seems that very large percentages of the elderly unification immigrants are brought here with the idea that they will soon be on public welfare. The facts would seem to indicate that after 3 years of residence—and I will show you one more chart—by these immigrants that we are trying to unify with family here, it goes from 4 percent, of immigrants on SSI within the first year of residence 3.6 after 1 year, 4.3 after 2 years, to a whopping 24.7 percent after 3 years. That is when the 3-year deeming period ends, which would almost lead one to conclude that many immigrants have this in mind, that after the 3 years, they will go on public welfare for either the disability aspects of SSI or—

When Do Immigrants Apply for SSI?



SOURCE: Congressional Budget Office

Senator EXON. Mr. Chairman, may I ask a question on that particular point?

Chairman DOMENICI. Of course.

Senator EXON. Isn't it also true—and I am not sure my facts are accurate on this, but I believe—that many of the people who are under this outreach proposal getting their relatives over here assume a contractual obligation to support them for the first 2 years—

Chairman DOMENICI. That is correct.

Senator EXON [continuing]. And after that, they no longer have to. Is that right?

Chairman DOMENICI. That is what we refer to as the "deeming" period.

Senator EXON. If there is anything that tends to prove that at least that period should be a longer period of time, at the very minimum, because obviously there is a spike in there after the contractual obligation of the United States citizen who outreaches to bring his or her relatives in that falls right, dead on the taxpayers' load after the first 2 years.

Chairman DOMENICI. You've got it. Actually, one of the immigration bills proposes a fairly lengthy period of time; it proposes 10 years, or some work period where you are actually working to put yourself on Social Security as others do.

Like I said, one of the reason why I think we have to look at this carefully is because, as a matter of fact, if we try to put a budget together, we are going to have to decide, even for this year, what we want to put in as the number that we expect in the future of savings from this whole area of legal immigrants participating, generally speaking, in our welfare system.

Senator EXON. Mr. Chairman, let me interrupt you, if I might, once again.

Chairman DOMENICI. Surely.

Senator EXON. I agree with you completely on this because one of the major concerns that this Senator has had with regard to balancing the budget by the year 2002—I mean, even if it all works out, and we accomplish something like that, I am looking into the future and wondering how in the world are we going to keep it balanced when and if we do it by the year 2002.

Chairman DOMENICI. I would also say that sometime during the morning here, we are going to hear that while most Americans really want to be decent and good people, it would appear that this has become a scheme, that actually, there are ethnic groups—one that is going to be cited is the Chinese—where a booklet is actually prepared and gets distributed, that suggests how an elderly immigrant who comes here can quickly get on SSI. That has become kind of a process which is being perpetuated.

I believe that if there is one area that is going to infuriate the American people if we do not fix it, it is the evidence on this chart of the overuse by immigrants, legal immigrants, elderly, who come here and quickly get on the welfare rolls of the United States.

We have got to find an answer, and we are going to hear from four witnesses today.

I will put my statement in the record and let you proceed with yours, Senator Exon, and then we will hear from the INS witness. [The opening statement of Chairman Domenici follows:]

OPENING STATEMENT OF CHAIRMAN PETE V. DOMENICI

I want to welcome the distinguished witnesses to this hearing, a hearing that will look at a relatively narrow part of government immigration policy—the public charge exclusion in immigration law and the enforcement of a sponsor's support affidavits.

I believe today's hearing is especially important because it addresses the small but growing problem of immigrant use of welfare and medical benefits.

The hearing also addresses one of the largest areas of disagreements in the welfare reform and balanced budget debates between Congress and the Administration.

The savings from immigrant restrictions are significant for both Congress and the Administration.

Savings from immigrant restrictions in the welfare reform conference was 30% of total savings—and 40% of total savings in the latest Republican offer. As for the Administration's welfare reform proposal, 20% of the savings came from immigrant restrictions.

Absolute dollar figures show a difference of about \$13 billion between the two proposals. The Administration proposes \$7 billion in savings and the Conference Agreement has almost \$20 billion in savings.

I would also note that the National Governor's Association welfare agreement did not recommend any changes to the Conference bill.

However, I do think we have to take a look at what is in the Welfare Reform bill. For example, the ban on providing lunches to illegal children is burdensome to local school districts.

We have to be sensitive to the effects on State and local governments. I would note that the Balanced Budget Act, as vetoed by the President, contained \$3.5 billion in additional medicaid funds for states with large immigrant communities.

At the same time it is important to send the message to those seeking to immigrate to this Nation that America may be the land of freedom and opportunity, but it is *not* the land of free lunches and lavish handouts. We cannot be the world's Social Security System.

Conventional wisdom, up until now, has been that immigrant use of welfare is no higher than the native population.

Evidence from Mr. Borjas, a researcher at Harvard University who is with us today, shows that is not the case. Immigrants use welfare and social services at higher rates than the native population and for longer periods of time.

The SSI Program, for example, has generated considerable interest recently due to a rapid increase in the number of elderly immigrants using SSI. Elderly immigrants represent almost 30% of all elderly SSI recipients, up from 6% in 1982.

Researchers are now talking about ethnic networks that educate their population about U.S. Government benefits. Norman Matloff talks of "a popular Chinese language book which includes a 36-page guide to SSI benefits."

Therefore, as the welfare stigma decreases and experience with wider varieties of government assistance programs increases, welfare use by immigrants will be an ever increasing problem in the future, both for the Federal Government as well as State governments.

Yet, given the growing number of immigrants showing up on welfare rolls, there seems to be a disconnect between immigration law and welfare law.

Current immigration law requires the INS and the State Department to screen possible immigrants for those likely to become public charges.

This screen for public charges is not new, in fact it has been a feature of national policy dating back to colonial days.

The most common way to satisfy the public charge requirement is for the immigrant to have a sponsor.

At the time of entry, both the sponsor *and* the immigrant sign documents stating that they *will not* become dependents on public assistance. The sponsor then pledges to be financially responsible for the immigrant.

What we are finding out, however, is that financial support generally lasts only as long as the affidavit requires. Fully half of legal permanent residents come on to the SSI rolls within 5 years of entering the United States. One quarter of the caseload comes on the rolls 3 years after entry, the year the support requirements end.

Legislation moving through Congress would make the affidavit of support a legally binding document. The President has proposed this himself.

Yet, most people do not ask the question, what does it mean in practice to enforce the support affidavit, especially as deeming periods become longer? Will sponsor "abandonment" increase as deeming becomes longer? Do we have the system and resources in place to effectively monitor and enforce this new provision of law?

In addition, how effective is our screen for those who may become a public charge and what is the reality that people can be deported after becoming a public charge?

How can we better use existing laws—like posting public charge bonds—to recoup public assistance costs?

These are just a few of the serious questions that must be addressed in restructuring immigration policy.

We have a distinguished group of witnesses before the committee today and on behalf of this committee I welcome each of you and thank you in advance for your testimony.

The first panel is David Martin, General Counsel of the Immigration and Naturalization Service. The INS and the Attorney General are principally responsible for enforcing support affidavits and controlling immigration.

The second panel consists of George Borjas from Harvard University, Mark Tajima from Los Angeles County Social Services and Karen Darner, Delegate to the Virginia Assembly and member of the National Conference of State Legislators.

We look forward to the testimony of all our witnesses.

OPENING STATEMENT OF SENATOR EXON

Senator EXON. Mr. Chairman, thank you very much. I have a rather brief statement that I want to read to try to put this in perspective of the way this Senator sees it, which may not be in agreement with all of our witnesses or America as a whole today.

I certainly want to thank my chairman for bringing up a very, very serious problem in the future that simply cannot be ignored. America, at one point in our history, welcomed with open arms almost anybody who emigrated to the United States. But even then, we had some immigration laws; we recognized that we could not open up our borders to unlimited immigration from all sources.

I happen to feel, though, that the Chairman has made some very interesting remarks and sets the record, and maybe the statement that I have prepared will add to that and help to focus the atten-

tion and the answers of the witnesses this morning at this very, very important hearing, especially as it affects the budget of the future.

This is indeed an important hearing, Mr. Chairman, and I congratulate you for calling it. During the recent Republican Presidential primaries, the issues of immigration has once again ignited obviously very strongly-held passions and views. The question of providing Federal benefits to aliens has quickly become a flashpoint in the debate.

I trust we can have a thoughtful discussion today that provides light rather than more sound and fury on this contentious issue.

I first want to say that we are a nation of immigrants, and we all know that. As President Kennedy so aptly put it, they remind us that "American society is a process, not a conclusion."

Our great Nation has been enriched, obviously, by the many tides of immigration over the past two centuries. Immigrants add new vitality to our Nation and rekindle and strengthen our senses of freedom and liberty. They help to make this country stand above all others in this world of ours.

There are, of course, limits—and that, I emphasize—there are limits, given the conditions that exist today in America and in the world, to the number of immigrants that our Nation can absorb at one time. We must have an orderly immigration policy, which I think we do not have today, something I have long been an advocate of, off the floor and on the floor of the United States Senate.

As my colleagues also know, I have supported denying—and I emphasize, denying—Federal benefits to those individuals who are not lawfully in the United States. I believe this is not only prudent immigration policy, but sound fiscal policy as well, as the Chairman has pointed out with the charts this morning.

Last September, I offered such an amendment to the welfare bill, which was overwhelmingly supported by my colleagues. Our efforts to balance the Federal budget are causing some very difficult decisions to be made regarding benefits for our own citizens, let alone illegal aliens.

I have often criticized the efforts as cutting too deeply into the benefits that we provide to our elderly and certainly to those whom we all recognize as the least fortunate among us.

Reducing our Federal spending on those who have broken our laws and have entered this country illegally is an area where I hope additional savings can and I think should be achieved.

My amendment recognizes that we need an exception for true emergencies and public health concerns. We should be firm, but not heartless. We should never turn away a sick person from a hospital emergency room. We should maintain vigilance when the public's health is at risk from communicable diseases such as tuberculosis, typhoid, cholera, and so forth.

But today's hearing reaches far beyond the issue of illegal aliens to whether benefits should be granted to those lawfully in the country. This is a most complex issue with enormous legal and social ramifications, and I trust we will take a judicious course in this hearing today and whatever follows.

I would simply emphasize, Mr. Chairman, that during this debate, I think there has been a great deal of confusion between legal

aliens and illegal aliens. Sometimes they are mixed all together. I think we have to separate them. Basically, they are two issues, but when it comes to welfare, they become combined into one very quickly.

First, there have been reports of welfare abuses in wholesale amounts, most notably by corrupt interpreters who are not just bending the rules but breaking them to gain Federal benefits for their clients.

I believe there is a unanimous agreement that we should crack down and crack down hard on these lawbreakers. I hear conflicting reports about whether much of the other evidence of fraud and abuse by legal immigrants may be anecdotal in nature or magnified beyond its true size. It would be most helpful to this Senator if the witnesses could provide the committee with some hard data upon which we could make an informed decision—how serious is the problem? If it is serious, what is the drain on our precious Federal resources, pointed out very clearly by the chart that the Chairman introduced into the hearing this morning? And what can be done to stop this drain?

I am also most interested in receiving testimony from our witnesses on the extent that legal aliens receive benefits, primarily SSI benefits, once again exhibited very vividly by the chart that the Chairman showed us this morning. Once again, I hope we can separate truth from heated rhetoric.

I hope our witnesses will be able to tell us with some authority why immigrant use has grown so dramatically, as it obviously has. Do they benefit from one or two programs, or from a host of programs? Can you give us some demographics?

Also, I want our witnesses to address trends and projections in this area. Where are we now, and where are we likely going? I also want to be sure that we take a close look before cutting SSI funds to those who are legally—and I emphasize legally—entitled to receive them under current law. The National Governors' Association, the National Association of Counties, the Conference of Mayors, and the National League of Cities have all expressed grave concern that they may be forced to pick up the slack. Instead of truly saving money, we will be shifting the costs of providing these services from the Federal Government to the States.

As an original cosponsor of the unfunded mandates bill that became law last year, I am concerned about this—is it another case of passing the buck with the bucks? I am also troubled that we may be creating an administrative nightmare. So we need your input.

In conclusion, Mr. Chairman, I certainly want to welcome our witnesses today to this morning's hearing. I doubt that we will resolve this complicated and thorny issue in one morning of testimony; however, this Senator is always interested in hearing any serious discussion that could lead to reducing the Federal deficit and balancing the budget.

As the Chairman indicated this morning, certainly this is a matter that very much concerns all of us who are budgeteers, especially with regard to the future.

Mr. Chairman, thank you very much.

Chairman DOMENICI. Thank you, Senator Exon?

Senator Frist, would you like to make an opening statement?

OPENING STATEMENT OF SENATOR FRIST

Senator FRIST. Thank you, Mr. Chairman.

Briefly, I commend you for holding this hearing today on the critical issue in our current budget debate, Federal welfare benefits for immigrants.

Rising immigrant use of Federal programs is contributing to a significant long-term problem and challenge in our country today, and that is runaway entitlement growth.

While immigrants clearly are not our largest group of entitlement beneficiaries, their participation rates are growing much faster than the aggregate of the population. In one Entitlement Program alone, supplemental security income, or SSI, immigrant participation has increased 580 percent from 1982 to 1994. More importantly, even though immigrants constitute only 8 to 9 percent of the population, they comprise 12 percent of SSI recipients.

I share these statistics today simply to stress that our short-term decisions have long-term consequences, and in medicine, we are trained to look at those long-term consequences and not just the 2-, 3-, or 4-year consequences.

What will America look like to prospective immigrants if runaway entitlement spending prevents us from performing our most basic Government function?

Thank you, Mr. Chairman.

Chairman DOMENICI. Senator Abraham?

OPENING STATEMENT OF SENATOR ABRAHAM

Senator ABRAHAM. Thank you, Mr. Chairman.

I would also like to start by thanking you for conducting today's hearing to try to focus attention on some of the problems that we do confront with regard to the issue of both welfare spending and its linkage to immigration.

Like many people here today and many people who are addressing this issue, I have tried to keep in mind the fact that my grandparents were immigrants; they came to this country about a century ago, and they came here not in search of welfare payments or social service programs, but they came here because they wanted to live in a country that was free, and they wanted to have a chance to see their children born and raised in a country that was free, and they wanted their kids to have the opportunity to pursue their dreams and to pursue the opportunity to have a little more education, a little more chance to own their own business, ultimately, and things of that sort, and they were successful in doing that.

We should keep that in mind as we address issues such as immigration. Separately, as you know, right now in the Judiciary Committee, we are marking up legislation pertaining to immigration laws. In my mind, there are problems with immigration in this country today, but most of them have to do with illegal immigration and not legal immigration. And one of the concerns I have is that in the legislation now before the Judiciary Committee, we are trying to merge these two together. I think they are very different topics, and I think it is important to try to address the problems

that we confront with respect to immigration, not by penalizing and hurting people who are trying to play by the rules, but rather by focusing on people who are not.

For those reasons, I think we need to move forward in a variety of ways to address those who are not playing by the rules. Primarily, I think that means trying to address the illegal immigration problems we have in this country today.

For example, I think we need to do a better job of preventing people from coming into the country illegal. In addition, I think we need to try to crack down on people who overstay their visas, which in fact constitutes about one-half of the illegal immigrant population in America today.

I think we also need to address the concerns many citizens have with respect to the benefits of welfare programs that are going to folks who are illegal immigrants; I think we need to bring that to an end.

And then, we have to deal with the questions that Senator Frist has just alluded to, as to whether some of the programs we have are being mishandled, misused, and abused.

So I appreciate the chance to confront some of these issues today. Several of them are addressed in the legislation we are looking at in the Judiciary Committee, and I appreciate the opportunity you are giving us today to do that.

Chairman DOMENICI. Thank you very much, Senator Abraham.

I know you know this, but I would just mention that much of the SSI disproportionate funding for aliens is for legal aliens.

Senator ABRAHAM. I understand. My concern, Mr. Chairman, is that if we do not address some of those problems, regardless of whether the beneficiaries are legal or illegal—let me say that if we do not address some of these problems in the way that you are suggesting, and the way we are trying to address it in the committee, I think what we are going to see is an overreaction that starts to say let us limit the number of people who can come to this country legally, and I do not want to see that happen.

Chairman DOMENICI. Well, I want to make my point very clear. I do not think an American policy that invites relatives in our country who bring in older relatives, knowing, that very shortly, they will be on SSI in the country—I am not sure that that is good American policy, and I think we have to look at that. That is a much different reason for immigration than existed when your grandparents came, or my parents or others. The very basis of it is different.

Senator Simon, did you want to comment? We have not heard from a witness yet.

OPENING STATEMENT OF SENATOR SIMON

Senator SIMON. I just arrived, and I apologize. I think your point on SSI is a very legitimate one. One of the proposals is that people who are sponsors should be responsible for a period of up to 5 years instead of 3 years, and really put some teeth in that. That would help.

There are some changes that should be made. Our biggest problem is obviously illegal immigration, not legal immigration, but this is one of those changes that I think we should be addressing.

Chairman DOMENICI. We are ready to hear from you, Mr. Martin. David Martin is general counsel for the Immigration and Naturalization Service.

Mr. Martin, your statement will be made a part of the record; that is the way we do it for almost every witness. Could you tell us how much time you need to feel comfortable for your oral presentation?

Mr. MARTIN. I believe it is about 10 minutes, the brief presentation that I have.

Chairman DOMENICI. All right. We will set the clock for 10 minutes, and if that is too burdensome, we will give you an additional 5.

Please proceed.

STATEMENT OF DAVID A. MARTIN, GENERAL COUNSEL, IMMIGRATION AND NATURALIZATION SERVICE, U.S. DEPARTMENT OF JUSTICE, ACCOMPANIED BY TONI MARWITZ, VISA OFFICE, U.S. DEPARTMENT OF STATE, AND LAVINIA LIMON, DIRECTOR, OFFICE OF REFUGEE RESETTLEMENT, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. MARTIN. Thank you very much, Mr. Chairman. I am pleased to have this opportunity to appear before the committee to testify on behalf of the Immigration and Naturalization Service and the Department of Justice concerning public charge issues.

Before I start my brief statement, I might point out that INS deals with only a portion of the issues that you have asked us to address today. The Department of State and the Department of Human Services, of course, address some very important elements of that. I wonder if it might be possible for my colleagues here from those departments to join me at the table; I think we can more effectively answer your questions after the statement, rather than if they ping-pong back and forth up to the table. Is that all right?

Chairman DOMENICI. I have no objection. Who are they?

Mr. MARTIN. Thank you. Lavinia Limon, from the Department of Health and Human Services; and Toni Marwitz, from the Department of State.

Chairman DOMENICI. Please join Mr. Martin at the table. And they are there to answer questions.

Mr. MARTIN. Yes; thank you, Mr. Chairman.

Before I discuss the three specific issues that I have been asked to address, let me first outline a broader perspective on questions raised by the public charge grounds of exclusion and deportation.

The Administration is firmly committed to the view that our immigration laws should reflect the cherished American traditions of strong family values and individual responsibility. At the same time, the laws should set forth a framework for legal immigration that promotes naturalization to encourage full participation in the National community.

The Administration supports legal immigration, the Administration supports the reunification of families, and the Administration firmly supports the goal of making individuals more responsible for the immigrants they sponsor.

We have serious concerns, however, about the policy and constitutionality of some proposed amendments to the Immigration and Nationality Act as applied to naturalized citizens.

The Administration strongly supports making the current affidavit of support legally binding. However, the provision in S. 1394 that would require the affidavit to be effective until the immigrant has worked for 40 qualifying quarters is, in our view, unreasonable. This provision would require a sponsor to remain subject to these obligations for a minimum of 10 years, potentially 5 to 7 years, or even more, after the immigrant becomes a citizen. In our view, all citizens should be treated equally whether native-born or naturalized.

In addition, we need to protect the access of appropriately admitted immigrants to the many diverse Federal, State and local programs that they are eligible to receive. In part, this includes ensuring that Cuban and Haitian entrants be exempt from the bill's restrictions on the receipt of public assistance.

The deeming requirement in S. 1394—that is, the provision that attributes the income and assets of the sponsor to the immigrants when they apply for public assistance—would affect many diverse Federal programs, including medicaid and student financial assistance for postsecondary education. It would, we fear, create new administrative complexities and requirements, and it would change the current deeming formula to include 100 percent of a sponsor's income and resources.

Attributing 100 percent to the sponsored immigrant does not take into account the needs of the sponsor or the sponsor's family, and in our view, it is inconsistent with current practice in the major entitlement programs.

The Administration also opposes subjecting student aid programs to the deeming rules. Access to student assistance by legal immigrants helps them obtain an education that can lead to a productive and self-sufficient life in the economic mainstream.

Having outlined the Administration's general position, I will now discuss in more detail the questions of specific interest to the committee.

The first has to do with affidavits of support. Let me put that into perspective. An alien is subject to exclusion from the United States if, in the opinion of the consular officer or of the Attorney General, the alien "is likely at any time to become a public charge." I am quoting from section 212 of the Immigration and Nationality Act.

Chairman DOMENICI. Would you state that one again, sir?

Mr. MARTIN. Yes; a person is to be excluded if he or she is deemed, in the opinion of the consular officer, to be "likely at any time to become a public charge."

Senator EXON. We haven't done a very good job on that one, have we?

Chairman DOMENICI. None.

Mr. MARTIN. Well, I will get into some of the complexities that have beset the enforcement, and we do think that there are certainly many elements in the proposal now that will help us overcome those obstacles to effective enforcement.

To continue to put that in perspective, an applicant for a visa or for admission may overcome this ground in many ways—for example, by demonstrating an employer's commitment for employment in the United States, by documenting bank accounts or other assets, by having a bond posted on his or her behalf.

For many years, administrative practice has also permitted someone to file a document called an "affidavit of support" on behalf of the alien. The person who signs this affidavit of support states that he or she is willing and able to support the alien and that the alien will not become a public charge.

Now, here come some of the difficulties. Section 213 of the Immigration and Nationality Act currently authorizes a lawsuit to recover on a bond or other undertaking should an alien become a public charge. But this provision is unavailing when an affidavit of support is used in lieu of a public charge bond.

In at least three States, courts have held that public agencies that provide public assistance to an alien may not sue the person who signed the affidavit of support on behalf of the alien to recover the cost of the assistance. And we are aware of no cases that have held that they are enforceable.

The Administration strongly supports amending the Immigration and Nationality Act, as proposed section 203 of S. 1394 does, so that those who sign an affidavit of support on behalf of aliens incur obligations that are in fact legally enforceable. The mechanism for enforcement of the affidavit of support under the bill would be relatively straightforward, especially if the improvements that we have suggested are made to the bill.

Essentially, it is an action for enforcement of a contract. Proposed section 203(e) of the bill grants clear jurisdiction in any Federal or State court for the sponsored alien to obtain the promised financial support if the sponsor does not come through with what has been promised. It also allows a suit for any affected Federal, State or local agency to obtain reimbursement from the sponsor. Such suits seek in essence to enforce the contractual obligation that will be inherent in the affidavit of support once the bill takes effect.

Nevertheless, let me just note briefly, the Administration does have a few reservations about section 203 in its current form. Most importantly, as currently drafted, a sponsor could continue to be liable to support the sponsored individual even after the individual becomes a citizen. We strongly oppose this provision, and we have doubts about its constitutionality, particularly as it ties in to the deeming provisions. Under the equal protection doctrine that the Fifth Amendment of the Constitution applies to the Federal Government, naturalized citizens may not be subjected to discrimination that "creates a second-class citizenship." I am quoting from the 1964 Supreme Court decision in *Schneider v. Rusk*.

Chairman DOMENICI. You do not think it would be legal if we put it as a condition to their coming to America, and said in it that if you become a citizen, the condition will continue? You do not think that would be legal?

Mr. MARTIN. No; in our view, as far as the deeming provisions are concerned, because that affects directly the Government's relation to the individual, we believe that that is overcome by the equal

protection doctrine announced in *Schneider v. Rusk*. It is a closer question with regard to the enforceability of the affidavits of support; that is arguably a contractual arrangement involving two private individuals in that setting.

Second, both sections 203 and 204—204 has the deeming provisions—would apply to benefits received under any Federal or State needs-based programs, including medicaid and other public health programs, and in-kind social services. We oppose such broad applicability because it would unduly harm overall public health and safety and significantly increase administrative enforcement costs.

Indeed, the Administration supports extending the deeming period for the major Federal and State cash benefit programs and making the affidavit of support, as I said, legally binding.

The time period applied to the affidavit of support and deeming policies must be consistent in order to minimize administrative enforcement costs, and we support extending that time period to until the sponsored alien becomes a naturalized citizen.

Now let me address the second question, and Mr. Chairman, if I might have a couple of additional minutes.

Chairman DOMENICI. Please; 2-more minutes.

Mr. MARTIN. Thank you.

The second question is deportation for having become a public charge. Section 241(a)(5) of the Immigration and Nationality Act provides that the Attorney General may order an alien's deportation if, within 5 years of entry, the alien becomes a public charge, with certain limited exceptions.

Enforcement of this provision, however, is quite difficult under the case law that interprets and applies this provision. Under *Matter of B-*, an administrative decision in 1948, the INS must prove that the alien accepted a form of public assistance which, under the applicable law, imposes on the alien a legally enforceable obligation to repay the assistance when the alien is able to do so. We must also prove that the responsible agency made a demand for payment and that the alien failed to pay. Obviously, this imposes real barriers to our being able to effectively enforce this section.

S. 1394 appears to be quite helpful in overcoming these difficulties. The proposed amendment clearly specifies that receipt of certain benefits for an aggregate period of more than 12 months makes an alien subject to deportation on public charge grounds.

The most reasonable inference from the creation of this list in the statute would be that INS would no longer have to prove that the alien failed to meet a legal obligation to repay. Accordingly, the strictures of *Matter of B-* would no longer frustrate enforcement of the statute.

The alien, on the other hand, is protected from an unduly harsh regime by the requirement that he or she receive the benefits for at least 12 months in the aggregate. Thus, if an alien falls upon hard times but needs public assistance for only a brief period, he or she would not lose the right to live in the United States.

The Administration does have certain reservations about this provision, and they are detailed in my statement. I will not go into them further at this time.

In particular I should just say that we believe the exemptions that apply there should also apply to Cuban and Haitian entrants

who are given certain special arrangements for assistance under the Fascell-Stone legislation.

Finally, Mr. Chairman, the third question I was asked to address has to do with aliens of limited earning potential. This issue is, of course, related to the public charge question.

The elderly parents of United States citizens may present a special concern along these lines, since it is unlikely that this class of aliens will work in the United States full-time. Proposed section 301 of S. 1394 addresses this issue by imposing substantial additional requirements in these cases. The Administration opposes many of these restrictions. In particular, the Administration believes that the value of family reunification to our communities and to the Nation relies on more complete family units than the bill currently contemplates. It includes a U.S. citizen's parents. In many U.S. citizen families, immigrant parents can provide essential household support, which will promote economic well-being and foster the rearing of children. Such reunified families often make the difference between a family that needs public assistance and one that is self-sufficient.

Therefore, the Administration opposes the extensive health insurance mandate on parents and the limitation of entry in the bill to parents who have a majority of children who normally reside in the United States.

I emphasize the Administration strongly believes in protecting against the misuse of public assistance programs, but it also seeks to strengthen families and to provide them with the means to become self-sufficient.

Thank you, Mr. Chairman. I would be happy to take your questions.

Chairman DOMENICI. Thank you very much, and we made your statement a part of the record.

Mr. MARTIN. Thank you.

[The prepared statement of Mr. Martin follows:]

PREPARED STATEMENT OF DAVID A. MARTIN, GENERAL COUNSEL IMMIGRATION AND NATURALIZATION SERVICE, U.S. DEPARTMENT OF JUSTICE

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear before the Committee to testify on behalf of the Immigration and Naturalization Service (INS) and the United States Department of Justice concerning those aspects of S. 1394, the Immigration Reform Act of 1995, that concern the Committee.

Before I discuss the three specific issues that I have been asked to address, let me first outline a broader perspective on questions raised by the public charge grounds of exclusion and deportation. Our immigration laws should reflect the cherished American traditions of strong family values and individual responsibility. At the same time they should set forth a framework for legal immigration that promotes naturalization to encourage full participation in the national community.

The Administration supports legal immigration, the Administration supports the reunification of families, and the Administration firmly supports the goal of making sponsors more responsible for the immigrants they sponsor. We have serious concerns, however, about the policy and constitutionality of some proposed amendments as applied to naturalized citizens.

The Administration strongly supports making the current affidavit of support legally binding. However, the provision in S. 1394 that would require the affidavit to be effective for 40 qualifying quarters is unreasonable. This provision would require a sponsor to remain subject to these obligations for a minimum of 10 years, potentially 5 to 7 years or more after the immigrant becomes a citizen. In our view, all citizens should be treated equally whether native-born or naturalized.

In addition, we need to protect the access of appropriately admitted immigrants to the many diverse Federal, State, and local programs they are eligible to receive. In part, this includes ensuring that Cuban and Haitian entrants be exempt from the bill's restrictions on receipt of public assistance. This recommendation is consistent with the Administration's position on providing assistance to Cuban parolees to facilitate their successful resettlement in the United States.

The deeming requirement in S. 1394 would affect many diverse federal programs—including Medicaid and student financial assistance for post-secondary education. It would create new administrative complexities and requirements, and change the current deeming formula to include 100 percent of a sponsor's

income and resources. Attributing 100 percent of a sponsor's income and resources to the sponsored immigrant does not take into account the needs of the sponsor or the sponsor's family and is inconsistent with current practice in the major entitlement programs. Access to student assistance by legal immigrants helps them obtain an education that can lead to a productive and self-sufficient life in the economic mainstream.

Having outlined the Administration's general position, I will now discuss, in more detail, the use of affidavits of support as a means to overcome an immigrant visa applicant's potential inadmissibility as an alien likely to become a public charge. Second, I will discuss the deportation ground that applies if an alien does, in fact, become a public charge. Finally, I will discuss the issue of the admission of aliens of limited earning potential.

Affidavits of support

An alien is subject to exclusion from the United States if, in the opinion of a consular officer or of the Attorney General, the alien "is likely at any time to become a public charge." Immigration and Nationality Act (INA) § 212(a)(4), 8 U.S.C. § 1182(a)(4). INA section 213 permits the Attorney General to admit an

alien who is excludable because the alien is likely to become a public charge, if someone files a bond or other undertaking against the alien's becoming a public charge. For many years, administrative practice has also permitted someone to file a document called an "affidavit of support" on behalf of the alien. The person who signs this affidavit of support, in effect, "guarantees" that he or she is willing and able to support the alien, and that the alien will not become a public charge. The affidavit of support is often used in lieu of the public charge bond provided for by section 213.

Section 213 currently authorizes a lawsuit to recover on a bond or other undertaking, should an alien become a public charge. But this provision is unavailing when an affidavit of support is used in lieu of a public charge bond. In at least three States, courts have held that public agencies that provide public assistance to an alien may not sue the person who signed an affidavit of support on behalf of the alien to recover the cost of the assistance. *San Diego County v. Vilorio*, 276 Cal. App. 2d 350, 80 Cal. Rptr. 869 (1969); *State ex rel. Attorney General v. Binder*, 356 Mich. 73, 96 N.W.2d 140 (1959); *California Department of Mental Hygiene v. Renel*, 10 Misc. 2d 402, 173 N.Y.S. 2d 231 (A.D. 1958), *aff'd*, 6 A.D.2d 782, 175 N.Y.S.2d 586 (1958), *aff'd*, 2 N.Y.2d 791, 188 N.Y.S.2d

186, 159 N.E.2d 678 (1959). The Michigan Supreme Court has also held that Michigan public assistance agencies may not consider the income of a person who executed an affidavit of support to be an alien's income, in determining the alien's eligibility for State public assistance programs, *El Souri v. Department of Social Services*, 429 Mich. 203, 414 N.W.2d 679 (1987), despite the fact that this "income deeming" is required in determining eligibility for Food Stamps, 7 U.S.C. § 2014(i)(1), Aid to Families with Dependent Children, 42 U.S.C. § 615, and for Supplemental Security Income, 42 U.S.C. § 1382j(a).

Proposed section 203 of S. 1394 is a marked improvement over current practice. Section 203 clarifies that an individual sponsor must meet certain requirements before the individual sponsor may file an affidavit of support. The sponsor must be a citizen or lawful permanent resident, must be at least 18, and must have a domicile in the United States or a territory or possession of the United States. The sponsor's income must be sufficient to equal at least 125% of the Federal poverty line for the sponsor and the sponsor's family, including the sponsored alien.

The Administration strongly supports amending the INA so that those who sign an affidavit of support on behalf of aliens incur obligations that are legally

enforceable. The mechanism for enforcement of the affidavit of support will be relatively straightforward once the improvements we have suggested are made to the bill. Proposed section 203(e) grants clear jurisdiction in any Federal or State court for the sponsored alien to obtain the promised financial support, or for any affected Federal, State, or local agency to obtain reimbursement, from the sponsor.

Nevertheless, the Administration does have five reservations about section 203 in its current form. First, as currently drafted, a sponsor could continue to be liable to support the sponsored individual, even after the individual becomes a citizen. We strongly oppose this provision and have doubts about its constitutionality, particularly as it ties to the deeming provisions. Under the equal protection doctrine that the Fifth Amendment applies to the Federal government, naturalized citizens may not be subjected to discrimination that "creates . . . a second-class citizenship." *Schneider v. Rusk*, 377 U.S. 163, 169 (1964). Moreover, the provision does not relieve the sponsor of liability if the alien is removed from the United States. Our law should not appear to impose this obligation on the sponsor, once the alien no longer has the right to live in the United States lawfully. Nor should the support obligation survive the sponsor's own poverty, bankruptcy, or death.

Second, both sections 203 and 204--regarding deeming--would apply to benefits received under any Federal or State needs-based programs, including Medicaid and other public health programs, and in-kind social services. We oppose such broad applicability because it would unduly harm overall public health and safety and significantly increase administrative enforcement costs. Instead, the Administration supports extending the deeming period for the major Federal and State cash benefit programs and making the affidavit of support legally binding. The time period applied to the affidavit of support and deeming policies must be consistent in order to minimize administrative enforcement costs, and we support extending that time period to until the sponsored alien becomes a naturalized citizen.

Third, proposed section 203(a)(2) requires the sponsor to support the alien until the alien has "worked in the United States for 40 qualifying quarters." The provision later defines "qualifying quarter" in terms of three month periods in which a sponsored individual's earnings reach certain levels and income tax liability guidelines. It is our understanding that for nearly 20 years the Social Security Administration has maintained earnings records on an annual rather than a quarterly basis. Therefore, it would be impossible to determine from social

security earnings whether the individual's earnings reached the designated level in a three month period of a year. We believe that section 203 should be amended so that it is consistent with current wage crediting procedures and deletes reference to income tax liability.

Fourth, section 203(b) should provide the Administration with at least 180 days to develop the new affidavit of support. The development of this new affidavit of support will require extensive interagency consultation, perhaps accompanied by notice and comment procedures in the *FEDERAL REGISTER*. The Secretary of the Treasury and the Commissioner of the Social Security Administration should be included in section 203(b) as officials who must be involved in this consultation.

Finally, section 203(d)(1)(B) appears to authorize the promulgation of regulations only with respect to section 203(d)(1)(A), rather than with respect to section 203 as a whole. As with most matters involving the immigration laws, it is the Attorney General, not the Commissioner of the Social Security Administration, who should have authority to promulgate regulations. We recommend a new provision authorizing the Attorney General to promulgate

regulations in consultation with the Secretary of the Treasury and the Commissioner of the Social Security Administration.

Deportation for having become a public charge

INA Section 241(a)(5) provides that the Attorney General may order an alien's deportation if, within five years of entry, the alien becomes a public charge. The alien may avoid deportation if the alien proves that he or she became a public charge from some cause that arose since the alien's entry. Enforcement of this provision, however, is difficult. In 1948, the Acting Attorney General approved the interpretation of the "public charge" provision adopted by Board of Immigration Appeals in *Matter of B-*, 3 I & N Dec. 323 (BIA 1948; Acting A.G. 1948). Under this decision, the INS must prove that the alien accepted a form of public assistance which, under the applicable law, imposes on the alien a legally enforceable obligation to repay the assistance when the alien is able to do so. We must also prove that the responsible agency made a demand for payment, and that the alien failed or refused to pay.

Section 202 of the S. 1394 appears to be quite helpful on this point. The proposed amendment clearly specifies that receipt of certain benefits including

AFDC, SSI, Medicaid, Food Stamps, State general assistance, and any other program of assistance funded in whole or in part by the Federal government for which eligibility is based on need for an aggregate period of more than 12 months makes an alien subject to deportation on public charge grounds. The most reasonable inference from the creation of this list would be that INS would no longer have to prove that the alien failed to meet a legal obligation to repay the assistance. Thus, the strictures of *Matter of B-* would no longer frustrate the enforcement of the statute. The alien is protected from an unduly harsh regime by the requirement that the alien receive the benefits for at least 12 months, in the aggregate. Thus, if the alien falls upon hard times, but needs public assistance for only a brief period, the alien would not lose the right to live in the United States.

The Administration does have three reservations about this provision, however. Because of these reservations, the Administration cannot support section 202 in its current form. First, the provision exempts from its provisions aliens admitted under INA section 207 as refugees and aliens granted asylum under INA section 208. This exemption is laudable, but it should be expanded to include certain aliens from Cuba and Haiti who have been paroled into the United States because of the situations that exist in those countries. Thus, aliens who

have been granted the protection of the United States, out of the ordinary course of the administration of the immigration laws would be at risk of deportation if they were to receive public assistance. Yet they are entitled to assistance, paid by the Federal government to help to alleviate the impact that their parole into the United States may have on State and local resources.

Our second reservation concerns the allocation of the burden of proof in deportation proceedings based on the alien's having become a public charge. Under current law, the alien must "affirmatively show" that he or she became a public charge because of some cause that arose after the alien entered the United States. The proposed amendment allows an alien to avoid deportation if the alien became a public charge because of some illness or disability that arose after entry.

If the alien suffers physical illness or injury, the malady must be sufficiently serious that the alien could not work at any job. A mental disability would excuse the alien from deportation only if it required "continuous hospitalization." As drafted, these provisions would impose on the INS a difficult, and potentially intrusive, investigatory and evidentiary burden. We would have to ascertain, and marshal evidence to prove, that the alien became a public charge because of a pre-existing condition or an illness or injury that was only relatively minor. We

believe that the amendment should retain the provision of current law that imposes on the alien the burden of proving that he or she meets the requirements of the exception.

Finally, proposed section 202(c) requires the Attorney General to review applications for naturalization or for certain immigration benefits to ensure that the applicant has not come into violation of the public charge provision. We do not oppose this provision *per se*. The provision does, however, give the Attorney General "discretion to *withhold or suspend* deportation pursuant to any other sections of..." the INA. "Withholding" and "suspension" of deportation are established terms of art under sections 243(h) and 244 of the INA. It would be preferable to revise the phrase to read "unless the Attorney General determines, as a matter of discretion, not to bring a deportation proceeding against the alien."

Aliens of limited earning potential

The issue of immigration of aliens with limited earning potential is, of course related to the public charge question. But the elderly parents of United States citizens present a special concern since it is unlikely that this class of aliens will ever work in the United States full time. Proposed section 301 of S. 1394

addresses this issue by imposing certain additional requirements in these cases.

First, an alien who is at least 65 years old could qualify for an immigrant visa as the immediate relative parent of a United States citizen only if more than half of the alien's sons and daughters are citizens or lawful permanent residents and normally reside in the United States. Secondly, in addition to the ordinary requirements for affidavits of support, the son or daughter seeking to bring the parent to the United States would have to agree to obtain for the parent health insurance that is at least comparable to the Medicare program and long-term health coverage that is at least comparable to the Medicaid program. This agreement must be part of the affidavit of support and would be legally enforceable by the alien parent or by the Federal government or any State, district, territory or possession that provides need-based financial or medical assistance due to the default of the petitioning son or daughter.

The Administration believes that the value of family reunification to our communities and nation relies on more complete family units than this bill contemplates. It includes U.S. citizens' parents. In many U.S. citizen families, immigrant parents can provide essential household support which promotes economic well-being and mobility. Such reunified families often make the

difference between a family that needs public assistance and one that is self-sufficient. Therefore, the Administration opposes the health insurance mandate on parents and the limitation of entry to parents who have a majority of children who normally reside in the U.S. The Administration strongly believes in protecting against the misuse of public assistance programs, but it also seeks to strengthen families and provide them with the means to become self-sufficient.

Once again, Mr. Chairman, I appreciate the opportunity to appear before you and address these issues. I will be happy to answer any questions that any Senator may have.

15

Chairman DOMENICI. Would the two people at the table who might answer questions identify yourselves and your title or occupation, please?

Ms. MARWITZ. My name is Toni Marwitz. I represent the Visa Office, where I am the director of field support and liaison in the Bureau of Consular Affairs, Department of State.

Ms. LIMON. Good morning. My name is Lavinia Limon. I am the director of the Office of Family Assistance, which administers AFDC and JOBS Program, and the director of the Office of Refugee Resettlement in HHS.

Chairman DOMENICI. Thank you.

Mr. Martin, as I understand it, INS is authorized to deport immigrants who become public charges.

Mr. MARTIN. That is correct.

Chairman DOMENICI. There are one-half million immigrants receiving SSI, and 1.2 million immigrants are recipients of food stamps—in other words, public charges. How many immigrants were deported for becoming public charges during the decade of the 1980's?

Mr. MARTIN. I do not have the figures on the whole decade. We could provide those for the record. But it is extremely limited, for the reasons that I detailed in my testimony—primarily the case law limitation, which requires that it be a form of assistance for which the alien has an obligation to repay and that the local agency made an unsuccessful demand for repayment in those cases.

I might also point out that the deportation ground is also limited to the first 5 years after entry, and there are certain other restrictions on it. But the main barrier to our effective enforcement of that is precisely the one I identified in the case law, and we certainly support changing the law to eliminate that barrier.

Chairman DOMENICI. Well, let me tell you that I know the answer, so I will tell you. The answer should be 13 in the decade of the 1980's—13.

Mr. MARTIN. Right.

Chairman DOMENICI. So your position is that the reason it is so few in number is that even though the law we currently have may not be as strong, you are saying various interpretations have made it rather difficult to enforce by way of deportation?

Mr. MARTIN. Yes, that is right. It was a decision many decades ago by the Board of Immigration Appeals, ratified by the Attorney General in 1948, and the statute as enacted in 1952 did not change that interpretation, and we have felt constrained to operate under that as well.

You are quite right, it has taken away any real effectiveness of that provision.

Chairman DOMENICI. The INS, Mr. Martin, is authorized to collect a public charge bond for aliens intending to emigrate to the United States. There are about 800,000 immigrants allowed in annually. Do you have any idea how many bonds were collected last year, or any of the three?

Mr. MARTIN. No, I do not have that information with me, Mr. Chairman. We could also provide that.

Chairman DOMENICI. I do not have the number, but I have a general statement. The answer should be "very few."

It does seem to me that the public charge bonds would address a number of the concerns of both Federal benefit programs as well as State and local governments. Do you have any idea why there are so few, if indeed it is "very few"?

Mr. MARTIN. Well, the bond can be used. As I said in my statement, that is one of many ways in which someone can overcome the initial ground of exclusion. Posting a bond requires a major outlay up front. It is used when it is deemed appropriate, but by and large, we believe that a more effective way to deal with this overall situation is to focus on the mechanism primarily used—the affidavit of support—and again overcome the case law that rendered those nonenforceable. The bill provision, which we firmly support, would make those enforceable as a contractual obligation and accomplish essentially the same result I think you are talking about, Senator.

Chairman DOMENICI. I have one last question. It is now commonly accepted that the chart I put up here is correct, that 30 percent of elderly SSI recipients are immigrants, and this number is increasing rather precipitously.

It seems to me that most elderly aliens, particularly those over 60 when they arrive, have little chance to contribute to the U.S. economy for any appreciable length of time. I might ask, who now develops the guidelines to screen applicants who are likely public charges, and what are the guidelines?

Mr. MARTIN. Well, the major guidelines, I believe, are contained in the Foreign Affairs Manual as it is applied by the consular officer.

Do you want to address that, Toni?

Ms. MARWITZ. Yes, sir. The Department of State has published regulations that deal with section 212(a)(4) of the Immigration and Nationality Act. This is the section of law that renders a person ineligible if that person appears to be a public charge.

Consular officers are guided by procedural and policy notes that are made available to every foreign service post in the world which processes immigrants for entry into the United States.

There are a number of factors we must consider in determining whether a person might become a public charge. We do not rely simply on the affidavit of support. Particularly for family members coming to the United States, we try to find out just what the income is of a family and what the ability of that family is to support the individual immigrant who is planning to enter the United States.

It is curious I think to note that we have statistics that show that in 1991, 7,287 potential immigrants were denied under section 212(a)(4). I will repeat that number—7,287 were denied because they were found excludable under section 212(a)(4) of the Immigration Act.

Chairman DOMENICI. Of how many that applied?

Ms. MARWITZ. That, I cannot tell you. I do not have the figures for how many were actually processed that year. But what is more surprising is that in 1995, that number quadrupled. We had 25,782 individuals denied out of a total of those who immigrated to the United States.

So that clearly, there is more emphasis being placed on the public charge considerations. Our officers are constantly being alerted to the concerns that you have raised and also public health concerns that enter into the equation as well.

Chairman DOMENICI. I will make one last observation and will state for the record one more time the history of SSI, which was \$9.3 billion 10 years ago, Senator Nickles, \$24 billion this year, and it will be \$40 billion by the year 2002.

Now, ma'am, if you are screening for possible public charge status, do you have any explanation as to why so many elderly foreigners are coming in, clearing those hurdles, and going on welfare and SSI?

Ms. MARWITZ. No, sir, I do not.

Chairman DOMENICI. Do you have any ideas, based on your experience, as to why that is happening?

Ms. MARWITZ. No, sir.

Chairman DOMENICI. Based on your work, there is no discovery on your part that it all might be part of a plan right up front?

Ms. MARWITZ. No, sir. We have never had an indication to that effect. We were somewhat surprised ourselves to learn of the Chinese scam that has been referred to.

It is becoming—it has become a very serious concern of ours, but we never had any indication in the field that this was a serious problem until the articles started appearing, and the attention was paid to it by legislators like yourselves.

Mr. MARTIN. Mr. Chairman, if I might add something on that, I think the initial screening that we do, however careful it is, is never going to be completely effective to address all of these issues. That is precisely why we support the changes that appear in the bill, to have an additional array of mechanisms available after the person enters if the prediction that has to be made beforehand proves to be incorrect; and the bill provides a number of those.

Chairman DOMENICI. Senator Exon?

Senator EXON. Mr. Chairman, thank you very much.

I would like to pursue this a little more along the same lines as the Chairman's questions. You indicated that there were 7,000 people denied, as I understood, because it was thought by the officer to whom the application was made in the foreign country that these individuals could well end up on the public assistance rolls; is that right?

Ms. MARWITZ. Yes, sir, but that was in 1991. Since then, the numbers have increased considerably.

Senator EXON. What numbers—the declines?

Ms. MARWITZ. They have increased considerably.

Senator EXON. Above the 7,000?

Ms. MARWITZ. Absolutely. This was in 1991. In 1995, there were 25,782 individuals who were refused under section 212(a)(4) of the Immigration Act. These were individuals found not to be able to overcome the presumption that they would become a public charge once they entered the United States.

Senator EXON. Was that based on becoming a charge when they entered the United States, or after the 3-year period that was referenced by the Chairman in the chart that he showed us at the beginning of the hearing?

Ms. MARWITZ. It is difficult to predict a person's future, but what consular officers look for is evidence that there is sound financial backing for that individual, evidence that is built up over a series of years.

Senator EXON. Sound financial backing for 3 years or for their life-expectancy?

Ms. MARWITZ. We do not look at life-expectancy, sir.

Senator EXON. You said 7,000, and now you say that in more recent years, 7,000 denials have increased to about 25,000; is that correct?

Ms. MARWITZ. That is correct.

Senator EXON. Of all those denials, is that a turn-down of 25 percent of those who make application, or 75 percent—what percentage do you think that might be?

Ms. MARWITZ. I do not know, sir. I would have to get that information.

Senator EXON. I wish you would get that for the record—

Ms. MARWITZ. Certainly.

Senator EXON [continuing]. Because the number of people that you have turned down is one figure, but that is only—unless we know how many applications were made, we cannot make an assessment as to how well the system is working, and that is what I would like to have for the record if I might.

Ms. MARWITZ. I would be glad to provide that for you, Senator.

[The following was subsequently supplied for the record by Mr. Marwitz:]

**Immigrant Visa Applicants Found
Ineligible As Possible Public Charges
Five Year Comparison**

Fiscal year	*Family-Based IVs Issued	**212(a)(4) Refusals	Total IVs Issued	**212(a)(4) Refusal Rate
1991	363,273	7,287	370,560	1.97%
1992	361,933	8,811	370,744	2.38%
1993	387,834	19,315	407,149	4.74%
1994	377,093	24,835	401,928	6.18%
1995	339,217	25,782	364,999	7.06%

*Family-Based Visas Issued figures include both Immediate Relatives of American citizens and visas issued to other family members of American citizens as well as spouses and children of Permanent Resident Aliens.

**Individuals who the consular officer believes are likely to become a public charge are excludable under Section 212(a)(4) of the Immigration and Nationality Act.

Statistics provided by the Office of Visa Services, U.S. Department of State, March 1996

Senator EXON. Mr. Martin, let me cite you a case, and I anticipate your answer is going to be that we just do not have enough money to do it. We had a recent case in Nebraska—in fact, last week—and there was a case very similar to it immediately preceding that within the last 30 days, where the State Patrol in the latest episode stopped a mobile home with Arizona license plates on it that was driving in an erratic fashion. When they stopped this driver, they found that there were 20, what obviously were illegal aliens, in this case from Mexico, who were being transported by this driver, who did have a driver's license, and I suspect the driver was possibly a legal alien, although I am not sure, but I think he probably was a legal alien. But the 20 people stacked up in the van obviously were not.

The State Patrol in Nebraska called the Immigration Service in both of these instances—the one that just happened within the last 7 days and the one that happened about 30 days ago—and the Immigration Service said, well, we wish we could come out, but we cannot; we are concentrating our efforts in the States with illegal aliens further to the south—meaning closer to Mexico—and they just did not have the personnel to come out and make an arrest or detain or anything. And the upshot of it all was they were allowed to go freely on their way.

This was on Interstate 80. You all know where Nebraska is geographically; it is quite a long way from the Mexican border and is a whole lot closer to the Canadian border. But it would appear that Interstate 80 now is becoming a major pipeline, and it was believed, although not proven, that this was part of a network, and

these illegal aliens were being transported to Chicago, which leads us to believe that there is a big network around the country with regard to these people getting in here and then paying this driver or the organization that he worked for to haul them to some place where they are dispersed around the country.

Why is it that the Immigration Service could not come out and enforce the law in the case that I just cited in Nebraska?

Mr. MARTIN. You have anticipated part of the answer, Senator. We are dealing with a situation that represents many years of neglect of really effective and systematic enforcement, adequately resourced, in this country.

The Administration, with very strong bipartisan support in the Congress, has been addressing the whole set of enforcement issues. Since 1993, we have been trying to deploy the additional resources that Congress has provided in a strategic way that enables us to build up our capacity in the most effective manner to deter future illegal migration.

With Congress' full support, we have concentrated initially on border enforcement—the pending bills all provide for major new additions to the border patrol and deployment to the Southwest border—but with this year's money, we are taking the next step to improve our capacity for interior enforcement both at the worksite and through removing people who are not entitled to be here.

You cannot deploy it overnight. We do have a process, and we are now very seriously into the phase of enhancing our interior enforcement, and we want to be able to do a better job on exactly the kind of case that you are talking about.

Senator EXON. Are the two cases that I cited in Nebraska in your opinion isolated cases, or is that going on all over the United States in every State?

Mr. MARTIN. Well, there are examples of that in other States besides Nebraska. We do try to establish the priorities for the use of our resources, and our major emphasis, of course, is on criminal aliens, so we emphasize our deployment of the resources we have right now to obtain that.

We are receiving a major increase in resources for this year, and a great part of that is to improve our capacity in the interior. We recognize the problems you have identified, and we have a long-term strategy for trying to address it.

Senator EXON. Mr. Chairman, my last question is also of Mr. Martin, and if he wishes to call on the people with him today, I will understand. Do you have with you today or could you supply for the record how many people who become public charges are deported under the current law? Let me state that again. How many people who become public charges are deported under current law? Who typically is deported, and under what circumstances? How would this change if the legislation proposed by Senator Simpson were enacted into law?

Mr. MARTIN. We can certainly provide those numbers. I have no reason to argue with the Chairman's numbers earlier. I do know that over the last 3 years, two people were deported specifically on the public charge ground.

Senator EXON. How many?

Mr. MARTIN. Two. Two over the last 3 years. Now, that is specifically because of the reasons that I indicated in my statement, that as the law has been interpreted and applied, there are very onerous requirements for demand for repayment by the individual. Only certain forms of public assistance make someone a public charge for the purposes of the deportation ground.

So that again, we certainly support the changes here; we believe they will make it much more possible to do an effective job of enforcing that particular deportation ground. I think it is too early to predict how many would fall afoul of that, but I am sure that our enforcement would increase substantially.

Senator EXON. Do you support the changes proposed to attack this problem as outlined in Senator Simpson's legislation?

Mr. MARTIN. Yes, in general, we do. We do have some specific reservations about particular elements of it, but the basic approach to improve our capacity to use the public charge ground of deportation, to extend the deeming period and tighten up those requirements, and to make the affidavit of support legally enforceable, those are all measures that we support. We do have certain refinements and changes that we would like to see in the specifics of some of those measures.

Senator EXON. Mr. Martin, I thank you and the people with you here today; and I thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator Exon.

Senator Frist?

Senator FRIST. Thank you, Mr. Chairman.

Mr. Martin, I would like to turn to the issue of the uninsured and health care, especially along the border States. As you know, the Administration has in the past made significant efforts to expand health care coverage to the uninsured and medicaid populations. If you look at the uninsured along the border States, the numbers are high, much higher when compared to the inner States. Texas is around 25 percent; New Mexico, 26 percent; Arizona, 24 percent; California, 23 percent. The National average is lower than that. In a State like Tennessee at this point in time, it was at 12, 13 percent, and now is down a little bit lower.

Does immigration, based on your experience, contribute to the rates of the uninsured and to the medicaid populations in these States?

Mr. MARTIN. I think I would defer that to HHS to address that question.

Ms. LIMON. Senator, I am only partially able to answer this question because medicaid is not my area of expertise. We do know that in a CBO study, they estimated that about 6.5 percent of medicaid recipients were legal immigrants, and in terms of the undocumented, they are only eligible for emergency medical care.

Senator FRIST. Do you have any data with you in terms of the actual cost of the immigration? Again, the statistics which you just gave me are for the country, nationwide, but I would also be interested in having the statistics for those border States.

And then, do you have any data with you today in terms of health care costs for immigration?

Ms. LIMON. I am afraid we do not have that, but we will get that information for you, including the border States.

Senator FRIST. I would be interested to see what those are from the Federal Government as well as the States, or at least those border States, compared to——

Chairman DOMENICI. Do you want to state it specifically, so they can get us the information? What is it you want, Senator?

Senator FRIST. What I would like is the health care cost of immigration as best you can calculate it as relates to medicaid and the uninsured, which is a harder figure to get at, for specifically the States of Texas, Arizona, California, New Mexico, as well as the National averages for those figures.

As you well know, Governors along those border States—and not just the border States, but the high-immigration States—have maintained that illegal aliens have increased the cost of medicaid and uncompensated care. I want to try to get at that if there is any way possible.

[The following was subsequently submitted for the record by Ms. Limon:]

The Current Population Survey provides estimates of the number of immigrants on medicaid and the number who are uninsured:

- 14 percent of the under-65 foreign-born non-U.S. citizen population has medicaid coverage (3 percent of these individuals have other coverage as well) and 41 percent of the same population is uninsured.
- 27 percent of the over-65 foreign-born non-U.S. citizen population has medicaid coverage (virtually all of whom have medicare as well) and 9 percent of the same population is uninsured.

However, these data are not sufficient to estimate medicaid and uncompensated care spending for immigrants. To make an accurate estimate, we would need immigrant-specific spending data. However, the Federal Government does not require States to provide immigrant-specific data.

Senator FRIST. Mr. Martin, according to CBO, legal immigrant applications for SSI grew from 55,500 in 1982 to 162,000 11 years later. Given what you know about the increasing use of welfare by immigrants, what will happen to welfare spending if we do nothing to change the immigration law or the welfare law?

Mr. MARTIN. Well, the trend line is obviously upward, but again, let me ask HHS to address that.

Ms. LIMON. SSI is under the Social Security Administration, so I can only answer some of these questions in terms of refugees, since one of my responsibilities is with refugees.

Refugees are about 17 percent of the total immigrants on SSI, so even though their numbers in terms of admission are lower, they do represent a disproportionate share of SSI acceptance in refugees.

Refugees are not subject to the public charge issues that have been discussed here. We admit refugees because of their well-founded fear of persecution. Often, we admit people who are unhealthy and unable to support themselves because they are not subject to that public charge. So refugees do disproportionately access SSI, and that is something that I wanted to make clear in this, that about 17 percent of the numbers that the Chairman showed were refugees—from the Soviet Union, from Cambodia, from Vietnam, from all around the world.

Senator FRIST. Has that 17 percent been constant over time—or, compared to 10 years ago——

Ms. LIMON. There are certain populations of refugees that utilize SSI at a higher rate. Refugees from the former Soviet Union use it about 28 percent. By contrast, only 3 percent of Latin American refugees utilize SSI. So there are big variations in populations. We bring a lot more aged refugees from the Soviet Union than we do from other places, and that is one of the reasons why that occurs.

Senator FRIST. I think that in testimony to follow this, we will go into that a little bit more, but just following up on that, does the INS have any knowledge that there certain groups, ethnic groups or regional groups, that are providing information back at home about eligibility for specific welfare benefits, which might encourage more people to come to this country?

Mr. MARTIN. I have seen Professor Borjas' testimony, and we have seen some accounts of that in other areas. Again, it is not our principal area of monitoring, but we are aware of some of that information that has been put forward on the public record.

Senator FRIST. We can come back to that, I guess, after his specific testimony.

Finally, we look at the trends, and the trends are pretty clear. I guess my final question would be is there any chance that immigrants' use of welfare benefits will decline without a change in the law?

Mr. MARTIN. It is really not my expertise to predict that. We do think it will decline with the changes in the law and specifically, the ones that we support and hope we will see in immigration reform legislation.

Senator FRIST. Thank you.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator Frist.

Senator Simon?

Senator SIMON. Thank you, Mr. Chairman.

Mr. Martin, as you know, we are in the throes of a markup on this bill; we have already had two sessions, and we will have at least two more, probably several more.

The figures that the Chairman used on SSI and food stamps—and they are pretty startling, particularly SSI—he used the figure 30 percent, and I have heard 28 percent. Maybe you could tell me which is the accurate figure, or is the 28 percent figure just an old figure?

Ms. LIMON. I am sorry, I would have to defer to SSI about that, and they are not here.

Senator SIMON. But in any event, it is a staggering cost; there is just no question about it.

Mr. Martin, when Senator Domenici talks about 500,000 on SSI and 1.2 million on food stamps—and perhaps, Senator Domenici, you could answer this, too—are these citizens and noncitizens, or are these only those who are not yet citizens?

Chairman DOMENICI. Not yet citizens.

Senator SIMON. So that we have 500,000 on SSI and 1.2 million getting food stamps who are not yet citizens. Can any of the three of you verify those figures?

Ms. LIMON. I can give you figures for AFDC, which are somewhere in between both of those figures. In 1993, there were 722,000 immigrants receiving AFDC, which is—

Senator SIMON. When you say "immigrants," these are noncitizens?

Ms. LIMON [continuing]. Noncitizens—which is about 5 percent of the total number of people receiving AFDC; about 5 percent of AFDC recipients are immigrants.

Chairman DOMENICI. Here it is—CBO, February of 1995, "Immigration and Welfare Reform." The numbers that I gave are in here.

Senator SIMON. All right. The public charge bonds—how do the bonds work? I hate to say it, because I am on the immigration subcommittee, but I do not know the answer to that question.

Mr. MARTIN. If that is used, if there is a requirement to post a bond, then it is done through customary bonding arrangements. Again, that has not been used as often as the affidavit of support, the problems of which we are specifically trying to overcome.

Senator SIMON. The affidavit of support, I understand; but the public charge bonds—are there 100 issued each year, or 1,000, 10,000, 100,000?

Mr. MARTIN. I am sorry I do not have that number, but I would be happy to provide that for the record.

Senator SIMON. I would like to have that. I think it ought to be entered in the record.

[The following was subsequently supplied for the record by Mr. Martin:]

Public Charge Bonds:

Historically, data on public charge bonds have been kept in the particular alien's file at the local INS District offices. Periodic nationwide audits are used to keep track of public charge bond trends. Beginning in April of 1996, a new Bond Management Information System will go on-line which will allow centralized tracking of public charge bonds and other forms of surety bonds accepted by the INS.

The immigration and Naturalization Service averages approximately 300 to 400 public charge bonds in a fiscal year.

The INS currently has approximately 380 public charge bonds in effect

How Public Charge Bonds Work:

Section 213 of the Immigration and Nationality Act allows for the admission, in the discretion of the Attorney General, of an alien who is found likely to become a public charge, if a bond is paid to the INS to indemnify the United States, States and localities against the alien's becoming a public charge.

When an alien applies for a visa to enter the United States, the consular officer will make a determination whether or not the alien is likely to become a public charge.

If the consul make a determination that the alien is likely to become a public charge, the consul may advise the applicant that he or she find a family member or other person in the United States to post a public charge bond. This is normally done in the United States at the district office of the INS. When the District Director's office notifies the consul that the bond has been posted, the consul may issue the visa. In some situations, the demand for a bond can be made in the first instance by an immigration inspector, an immigration judge, or by the Board of Immigration Appeals.

Most public charge bonds are posted through a bonding company in the form of a surety bond. All surety bonds are posted by executing a Form I-352 which will contain the face amount of the bond and all obligations and rights of the obligor. The amount of the bond must be at least \$1,000. The bond agreement may also have riders attached. The District Director is authorized to approve the bond and most legal agreements related to the bond. Certain matters must be referred to the Regional Directors. 8 C.F.R. 103.6(a). The obligor may also deposit cash in lieu of such bond together with a Form I-352 and a power of attorney authorizing collection of the deposit in the event of a violation.

The public charge bond requires that the obligor will pay to the United States, or to any State, territory, county, town, municipality, or district all expenses that result from the alien's becoming a public charge after entry. Any violation of the bond also allows liquidated damages, in the amount of \$200 payable out of the face

amount of the bond, to the United States. The United States may enforce the bond on behalf of States and localities who have incurred expenses from the alien becoming a public charge.

Senator SIMON. And in your opinion, is the public charge bond working, or is it not working at all, or is it a barrier to people who may want to come in and abuse the system? What is your reaction?

Mr. MARTIN. That in itself, when it is employed, yes, it provides security against someone going on public assistance after they come in. Looking to the future to resolve these kinds of issues about which we are also concerned, we think the most effective way is to deal with it through making the affidavit of support itself legally enforceable and also extending the deeming provisions for certain of the programs, particularly the cash assistance programs, in the way that is outlined in my testimony. Overall, I think that is going to be a more effective, more easily administered way to deal with these issues than somehow trying to expand the use of the posting of bonds. It requires an initial cash outlay that may be quite substantial for someone who wants to bring a family member in, even for people who are quite willing along the way to provide the assistance and support that is pledged in the affidavit of support.

And I should emphasize that most people who file the affidavit of support follow through on that. Even though it is not now legally enforceable, it does represent a commitment that many people undertake now to bring their family members into this country.

Senator SIMON. My staff handed me a Washington Times story from yesterday on estimated Government expenditure for various welfare and public assistance programs for immigrants and Native Americans, or for those of us who are citizens, nonimmigrants. But I assume it is a per capita expenditure for those who are on welfare, so it is really kind of meaningless, but does show that the immigrant costs per capita are less than for those of the rest of us who get on welfare in the United States.

Chairman DOMENICI. Senator, might I make an observation with reference to the affidavits of support?

Senator SIMON. Yes.

Chairman DOMENICI. There is a very big difference of opinion between the White House negotiators and the Republicans with regard to that. You see, if that is the principal means of enforcement, then it is sort of like child support—who is going to enforce this with the 500,000, 600,000 who are out there?

The issue that we raise is, for a period of time, should they not just be denied the opportunity to receive the SSI—and you could make exceptions for someone who truly got disabled by accident or the like. And for some reason, in the negotiations—and I am not saying the President himself—but it became kind of—one is too stringent. Yet we were trying to ask who is going to enforce these. Obviously, we have them now, and while they are saying that they are not very enforceable, the truth of the matter is that nobody tried very hard. Eventually, the court made it almost impossible.

But what I really think is happening is that everywhere we turn, there is evidence that people of elderly status are deciding that they want to be on our welfare system as soon as possible.

And let me even suggest another spike that is very interesting. For elderly immigrants who were brought here by their relatives, there was a lull in whether they ever applied to be American citizens. Many of them just stayed on in the status of immigrants who were illegal immigrants.

The spike is that now, after 3 years, they are beginning to apply, and after 5 years, they are certainly applying, and the reason is because, as the good counsel has told us, according to the Supreme Court, they cannot be denied welfare benefits if they become citizens, regardless of what went before that.

So you and that committee have some real work to do with reference to how you fix this.

Senator SIMON. Senator Abraham is on that committee, too.

I am a great defender of legal immigration; I think it is a great plus for our country. But I do not think there is any question that we have some abuses here that we have to deal with. I do not believe that you can have two categories of citizens. I think, Mr. Martin, the equal protection clause would clearly make that unconstitutional. But I do think, however, that we need to tighten up on the public charge bonds and to say, prospectively—not retroactively, but prospectively—to people: You are going to have to be responsible for 5 years and not just for 3 years.

Mr. MARTIN. Mr. Chairman, if I could just address one point that you raised about the difficulties of public agencies enforcing the affidavits of support even if they are made directly enforceable.

Chairman DOMENICI. Please.

Mr. MARTIN. We see the proposals here as part of an overall package. It is not just the enforceability of the affidavits of support, although that is an important element. It is also, importantly, the changes in the deeming rules. That, we believe, is the major way in which we would avoid people coming in and quickly trying to get on the public assistance rolls. But there is another important element in the Senate bill. The affidavits of support are enforceable not only by the public agencies, but also by the individual. So that if the sponsor simply ceases to do what he or she had originally pledged to do, their resources will nonetheless be deemed or attributed to the immigrant, but the immigrant would also then have the capacity to go into court and enforce the contractual obligation.

So that as it is set up in the Senate bill, it is not entirely dependent upon administrative agencies for trying to seek that kind of enforcement. We see that as an overall package, and we believe that that is an important element in turning this into a system that really works to accomplish the goals that we share.

Chairman DOMENICI. Thank you, Senator Simon.

Senator Abraham?

Senator ABRAHAM. Just to clarify, you believe that if the sponsorship agreements are made legally binding, that would provide you with a kind of tool that heretofore we have not been able to use.

Mr. MARTIN. Yes.

Senator ABRAHAM. What is the Administration's position, then, with respect to the provisions that we have in the Simpson bill as well as a bill that I have introduced—as well as in the welfare reform bill—that would deny SSI benefits to noncitizens?

Mr. MARTIN. We believe that the deeming approach is the more appropriate way. In many cases, it would accomplish the same result. But the deeming approach, as we have supported and as I believe has been outlined more extensively by other agencies in the debate on the welfare reform bill, provides more adequately for specific circumstances in which there might be exceptions or in which the sponsor, despite good faith efforts to begin with and intention to support the person, may fall into poverty himself.

We do not see that as a major change, but we do think it is important to have that sort of flexibility to address individual circumstances.

Senator ABRAHAM. But you do not feel that the sponsorship agreement should be extended after the point when someone becomes a citizen; is that the Administration's position?

Mr. MARTIN. That is correct, yes.

Senator ABRAHAM. Could you just outline the basis for that a little more fully than you did earlier?

Mr. MARTIN. Principally, as a matter of policy, we think we should encourage naturalization; we should see naturalization or citizenship as a point when someone becomes a full member of the society. It has been a part of our policy to encourage naturalization and to promote it. It is part of American tradition that that is seen as really the endpoint of the whole immigration process. We want people to become part of this welcoming community.

In that context, we believe that once someone achieves the point of citizenship, the same rules should apply to them as to anyone else.

As I mentioned earlier in my testimony, certain of the distinctions that would be drawn between naturalized citizens and native-born citizens, we believe would have very serious constitutional problems under the *Schneider v. Rusk* case.

Senator ABRAHAM. I voted with Senator Feinstein when we had this before us as a welfare bill; I do not believe you can distinguish, and I do not think it would be appropriate to distinguish between the sorts of benefits that citizens receive. But it seems to me that the sponsorship agreement is a contractual relationship. I do not understand why that would—I mean, if in fact terminating the sponsorship agreement becomes an incentive to become a citizen and thus become in some way or another a public charge, it does not seem to me that that is consistent or necessarily a part of the move toward naturalization that the Administration would want to embrace.

I guess I am having a hard time seeing those as consistent. It just seem to me that, yes, we would all like to encourage people to move toward full citizenship, but if the idea is to provide the incentive that you no longer are the responsibility of someone who has made this kind of contractual agreement, I am not sure that that is consistent. Why do you think it is?

Mr. MARTIN. Well, no, we do not want to see that primarily as a way that we are inducing people to become citizens. We look at it in the other direction. We do want to encourage people to become citizens. We are promoting that, and we think that that is consistent with American heritage. As part of that, when you arrive at that stage, you should assume the mantle of citizenship on equal

terms with others, and that would include applying under the same provisions for any Public Assistance Program.

Senator ABRAHAM. So we would not be under this approach denying those people who become citizens benefits; we would only be saying that the sponsor still has an obligation in some way or another to compensate for those benefits that are being used.

This is where I am a little bit—I totally accept the constitutional issues with regard to the denial of benefits, but it seems to me that this is really not much different than where someone takes on any other sort of obligation one might have toward the Government—for example, tax liens or anything else. I guess I have a hard time seeing why that cannot be extended.

Let me move to another topic. You earlier talked about people who were deported under the public charges category. Can we talk a little bit about criminal aliens? What percentage of criminal aliens in this country who are deportable under the current laws actually are deported? And I hasten to add up front here that I am not trying to hold INS or anybody accountable here. I realize the complexity of that process. But could you tell us approximately what the percentage is of people who are deportable?

Mr. MARTIN. What I can give you is the number of criminal aliens who were formally deported last year. That was 31,000, a significant increase over earlier years. The trend line has been upward, and that has been a major emphasis for this Administration.

I do not have a figure on the total universe from which that is drawn. To give an indication, the best estimate we have of the number of foreign-born who are in State and Federal prisons around the country is approximately 100,000. Now, not all of those are aliens. Some of those would have been citizens. But the way the statistics are kept, they tend to detail foreign-born rather than current nationality.

So we are certainly increasing our efforts along those lines, and we have adopted many new steps to do it, and I think we are showing improvement in that area.

Senator ABRAHAM. I appreciate that, and in fact I am pleased to see that the percentage or the number of people who are deportable who are in this country and have committed crimes are now being deported. The problem is a lot of people do not get deported, and they get back into the communities; and I assume a certain percentage of those people not only commit other crimes, but also another percentage fits into this category of individuals who then begin to collect benefits.

So one of the things that I hope we will be able to deal with more extensively in our legislation in the Judiciary Committee is trying to make it more feasible for INS to address these problems. Right now, there is no containment policy, and people, once released, can literally go back into communities and become very hard to locate for purposes of deportation hearings as well as the steps that impede the deportation.

Are you able to comment at all on some of the provisions with respect to criminal alien deportation in the legislation we are looking at, because I think it gets at these cost issues in a whole different way.

Mr. MARTIN. Well, yes, there are improvements in the Senate bill that we have supported that would help our efforts across-the-board on removing people once they have—well, removing people who are deportable from the United States. In addition to those efforts, we are undertaking major new resource deployments and major new strategies to deal with criminal aliens, and that is ongoing.

With regard to whether some of these people are tapping into the benefit system, we do have the SAVE Program—Systematic Alien Verification for Entitlements—and that is used by a wide variety of public assistance programs. SAVE checks our indices to verify the person's immigration status, and it should show up if the person had a deportation order. If for some reason it was not enforced, that information should show up, and it should help us to block them from gaining access to the program.

Senator ABRAHAM. Mr. Chairman, I would just say that that is another area that I think we should be thinking about as we address this problem, because 31,000 is a positive step in the direction I think we need to move, but that is only a fraction of the number of people who are deportable under our existing laws for having committed serious crimes and yet we do not get to a very substantial number on.

Chairman DOMENICI. We are going to move to our next witnesses. I want to thank the three of you for your testimony, and we will submit some of those questions which were a little bit cumbersome in writing so you will know what it is we would like. Thank you very much.

I now call Mr. George Borjas, with the Kennedy School of Government, Harvard University; Mr. Mark Tajima, a senior analyst with Los Angeles County Chief Administrative Office; and Delegate Karen Darner, National Conference of State Legislatures.

Would all three of you take your places at the table, please, and we will start with Mr. Borjas. Do you have written testimony?

Mr. BORJAS. Yes, I do, and I believe the committee has it.

Chairman DOMENICI. We will make it part of the record, and what about 7 minutes to complete your oral remarks, and we will do the same for each of you, and if you are really pushed, we will add a little bit to it.

Please proceed.

STATEMENT OF GEORGE J. BORJAS, PROFESSOR OF PUBLIC POLICY, JOHN F. KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY

Mr. BORJAS. Thank you very much, Mr. Chairman, and I thank the committee for giving me the opportunity to come here and talk about my current work in connection with immigration and welfare.

As many of you have heard already, there is a clear perception and fact that immigrant participation in welfare programs is on the rise and is on the rise very rapidly.

In terms of academic studies, most of that perception and knowledge comes from studying the decennial Census data. We can actually look back to 1970 using Census data, and it turns out that back in 1970, we would not have been having this kind of debate.

Back in 1970, Census data actually show that immigrant households were less likely to receive welfare than native households by about 21 percentage points.

That fact changed by 1990, when about 9 percent of immigrant households were receiving some kind of cash benefit assistance, AFDC or SSI, as opposed to only 7.5 percent of native-born households.

The Census, however, does not provide any information on things other than cash benefits; in particular, it provides no information whatsoever on things like medicaid, food stamps, energy assistance, housing assistance and the many, many, many other programs that make up what we call the welfare state.

This lack of information can be very important because, as many of you know, these noncash programs are far, far more expensive than the cash programs in terms of the total cost of maintaining the welfare state.

Recently available data from the Census Bureau does provide information on the extent to which native households and foreign-born households use these other kinds of programs, and it turns out that once we include these other programs, the picture changes quite radically, and in particular it provides a much more disturbing picture of the extent to which immigrants use some kind of welfare assistance, whether it be cash benefits, medicaid, food stamps, or something else.

Just to give you an idea of what the numbers look like, if you look at the early 1990's, in a typical month in the early 1990's, something like 20 percent of immigrant households, foreign-born households, received some kind of assistance, and by that, I mean either some cash benefit or medicaid or food stamps or housing-type assistance, as opposed to only 14 percent of native-born households. And that discrepancy is even larger if one compares foreign-born households to white, non-Hispanic native-born households; that would be 20 percent versus 10 percent. So it is actually quite a big gap in the extent to which immigrants use all these other programs, once we add the noncash benefits.

A lot of what is going on can be attributed directly to medicaid, medicaid being by far the most expensive program. So that once you bring medicaid into the picture, you get a much bigger gap between foreign-born and native-born households.

One can also use these data to calculate the fraction of the dollar benefits, in other words, the value of benefits, that are distributed to foreign-born households. Again, in the early 1990's, foreign-born households in these Census data make up about 8 percent of the total population. Those 8 percent of the people, if you take this data and calculate it, received almost 14 percent of all the benefits. There is a clear discrepancy what you would expect if immigrant households were like native-born households, and in fact that discrepancy is even larger in California, which happens to be the largest State, with very generous welfare programs, and also has a very large number of immigrants.

In California, immigrants make up 21 percent of households, and that 21 percent of households receive something like 40 percent of all welfare benefits.

It is not too far-fetched to claim that in the near future, within a decade or two, if the present trend line continues, the welfare problem in California will really be mainly an immigrant problem.

One other thing one can do with these data is actually track households over time and try to decipher whether their participation in these programs is temporary or long-term. Again, the evidence points to a somewhat disturbing conclusion which is that immigrant households much more than native households tend to be in the program for a much longer time. In other words, immigrant households are not only more likely to be in the program, but once on these programs, they tend to stay longer. And the difference in the duration of the spell of welfare reciprocity is actually significant.

One thing that the data also show is that these gaps between immigrant households and native-born households are not due to the fact that immigrant households are immigrant. It is not immigrant-ness per se that creates that gap. It is the socioeconomic characteristics of immigrant households—in other words, their lower skill levels, their age composition, and the gender composition of the household and so on—that tends to explain why immigrant households collect more welfare benefits than native-born households. It is not because they are immigrant; it is simply because they have the characteristics that tend to make them qualify for these programs, and they participate in these programs.

Let me conclude with one more fact from the analysis I have conducted. That is the fact that there seems to be a very strong correlation between the kinds of programs that newly-arrived immigrants receive from particular national origin groups, and the kinds of programs that members of the Nation origin group receive prior to their arrival.

In other words, if some group receives things like housing assistance or energy assistance, the new arrivals will also tend to receive those benefits. That correlation tends to indicate some kind of transmission of information within the ethnic community not only about job opportunities, but also about welfare opportunities.

And in fact there is some anecdotal evidence that has been collected by a professor at the University of California, Norman Matloff, who actually has gone through Chinese language newspapers and books and shows that indeed information about these programs is published in China, in Chinese newspapers, showing new arrivals what they can qualify for and what the process is like.

In sum, I think there are a few new things in these data that are worth keeping in mind during the policy debate. It is a fact, an undeniable fact, that foreign-born households are more likely to receive benefits; that once they get on these programs, they tend to stay on the programs longer; that a lot of the gap can be explained in terms of the differences in socioeconomic variables and not due to the fact that they are immigrants per se; and that there seem to be some networks within the ethnic communities that transmit information about these programs.

Thank you very much.

Chairman DOMENICI. Thank you.

[The prepared statement of Mr. Borjas follows:]

IMMIGRANT PARTICIPATION IN WELFARE PROGRAMS

George J. Borjas*

The perception that immigrant participation in welfare programs is on the rise has fueled an increasing concern over the impact of immigration on the costs of servicing the welfare state. The current conventional wisdom is that an increasing number of immigrants are beneficiaries of welfare programs, but that the gap between immigrants and natives is not very large. For the most part, this inference is drawn from the analysis of decennial Census data. Since 1970, the Census reports whether households receive *cash benefits*, such as Aid to Families with Dependent Children (AFDC) or Supplemental Security Income (SSI). In 1970, immigrant households were slightly less likely than native households to receive cash benefits. By 1990, however, the typical immigrant household had a higher probability of receiving cash benefits. In particular, 9.1 percent of the immigrant households enumerated in the 1990 Census received public assistance, as compared to only 7.4 percent of native households.

The Census, however, does not provide any information on noncash transfers, such as Food Stamps, Medicaid, housing subsidies, and the myriad of other programs which make up the modern welfare state. As a result, we do not truly know the extent to which immigrants participate in welfare programs, where welfare is taken to mean the whole range of means-tested programs available to low-income households and not just the cash benefit programs. This lack of information can have important financial consequences. After all, the total costs of all means-tested entitlement programs in 1991 exceeded \$180 billion, but cash programs accounted for less than a quarter of the cost of these programs.

Recently available data provide a more complete picture of immigrant participation in the wide array of means-tested programs that make up the modern welfare state. The Survey of Income and Program Participation (SIPP), which is also collected by the Census Bureau, contains extensive information on participation in practically all means-tested programs for a large number of households. The "welfare gap" between immigrants and natives is much larger

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when other programs are included in the analysis. The data also indicate, however, that much of the welfare gap can be explained in terms of the less favorable socioeconomic background which now characterizes the immigrant population. Finally, there is evidence that the types of welfare benefits received by earlier immigrant waves influence the types of benefits received by newly arrived immigrants. Hence there might be networks operating within ethnic communities which transmit information about the availability of particular types of benefits to new arrivals.

The Trends

The Survey of Income and Program Participation records the economic experiences of thousands of randomly selected households over a 32-month period. We can use these data to calculate the probability that a household, whether immigrant or native, receives a particular type of public assistance during a given month. Table 1 reports the evidence for the period covering roughly the years 1990-1993.

The data are direct and striking: immigrants are more likely to participate in practically every one of the major means-tested programs. In the early 1990s, the typical immigrant household had a 4.4 percent probability of receiving benefits from the AFDC program, as compared to only 2.9 percent for native households. Similarly, over 9 percent of immigrant households received food stamps, as opposed to only 6.5 percent of native households. Finally, 15.4 percent of immigrant households were covered by Medicaid, as compared to only 9.4 percent of native households.

The evidence also suggests that the conventional wisdom, so heavily influenced by the evidence from cash benefit programs, *understates* the extent to which immigrant households truly benefit from public assistance. To obtain a more inclusive measure of welfare participation, we can calculate the monthly probability that a household received either cash benefits, Medicaid, Food Stamps, WIC, energy assistance, or housing subsidies. Using this definition of welfare, we find that 20.7 percent of immigrant households received some type of assistance in the early 1990s, as compared to only 14.1 percent of native households, a welfare gap of 6.6 percentage points. The gap is even more striking if we compare immigrant households to non-Hispanic white native households: immigrants are then almost twice as likely to receive some type of assistance (20.7 percent versus 10.5 percent).

In addition to indicating if a household participates in a particular program, the SIPP reports the dollar value of the benefits received in many of the programs. These data allow us to calculate the fraction of benefits that are disbursed to immigrant households. Not surprisingly, immigrant households account for a disproportionately large fraction of the costs of these programs. In the early 1990s, 8.0 percent of the households were foreign-born. These immigrant households accounted for 13.8 percent of the costs of the programs, almost 60 percent more than their representation in the population.

The disproportionate disbursement of benefits to immigrant households is particularly acute in California, a state which has both a lot of immigrants and very generous welfare programs. Immigrants make up 21.0 percent of the households in California, but these households receive 39.5 percent of all benefits distributed in the state. It is not too much of an exaggeration to say that the welfare problem in California is on the verge of becoming an immigrant problem.

Some observers of immigrant welfare use dismiss the immigrant-native welfare gap as being attributable solely to refugees and/or to elderly immigrants. We can check the validity of this argument by "taking out" from the calculations the immigrant households that either originate in refugee-sending countries or contain at least one elderly person (over age 65). It turns out that 17.3 percent of immigrant households in this restricted population receive some type of assistance, as compared to 13.0 percent of native households that do not contain any elderly persons. This welfare gap of 4.3 percentage points is still sizable, so that the argument that the welfare problem in the immigrant population arises because of refugees and the elderly is factually incorrect.

Because the SIPP data track a particular household over a 32-month period, we can determine if immigrant participation in welfare programs is temporary or long-term. Although this distinction has not been stressed in the public debate, it is a crucial distinction. After all, the policy implications of having a long-term dependent immigrant population are quite different from those of having immigrants who require short-term aid, perhaps during a transition period in their first few years in the United States.

During the early 1990s, only 68.7 percent of immigrant households did *not* participate in these programs at any point in the 32-month tracking period, as compared to 77.3 percent of

native households. Moreover, 10.3 percent of immigrant households received welfare benefits throughout the *entire* 32-month period, as compared to only 7.3 percent of native households. Put differently, immigrants are not only more likely to have some exposure to the welfare system; they are also more likely to become “permanent” recipients. These trends are disturbing because they suggest that unless eligibility requirements are made much more stringent much of the welfare use that we now see in the immigrant population may remain with us for the next two or three decades. The trend also raises troubling questions about the impact of this long-term dependency on the immigrant household’s social and economic prospects, as well as on the prospects for the U.S.-born children of these households.

The raw data summarized in Table 1 addresses the key policy question of whether immigrants use welfare programs more often than natives. Nevertheless, it is of interest to determine if differences in *observable* demographic characteristics between the two groups explain the welfare gap. The statistical analysis of the SIPP data shows that differences in household composition (such as the age and gender of the various household members) account for about 1 to 2 percentage points of the welfare gap between immigrants and natives, and that differences in the socioeconomic background of the householder (such as the householder’s age and, most notably, education) account for about 2 to 3 percentage points of the gap. In other words, immigrants tend to receive more welfare not because they are immigrants, but because their socioeconomic characteristics are highly correlated with welfare use.

This result has important implications for immigration policy: A small number of observable socioeconomic characteristics can assess the probability that a visa applicant will become a welfare recipient upon entry into the United States.

Ethnic Welfare Networks?

There is a huge amount of dispersion in welfare participation among national origin groups in the immigrant population. About 4.3 percent of the households originating in Germany, 26.8 percent of those from Mexico, and 40.6 percent of those from the former Soviet Union are covered by Medicaid. Similarly, about 17.2 percent of the households originating in Italy, 36.0 percent of those from Mexico, and over 50 percent of those from the Dominican Republic received some type of benefit.

These national origin differentials suggest a very interesting fact: some national origin groups tend to “major” in receiving particular types of benefits, and tend to avoid other programs. For example, even though Mexican immigrants are 50 percent more likely to receive energy assistance than Cuban immigrants, Cuban immigrants are more likely to receive housing subsidies than Mexican immigrants. Obviously, some of this variation can be attributed to differences in demographic characteristics between Cuban and Mexican households (such as household size, gender and age composition, and state of residence). Nevertheless, the link between national origin and participation in *specific* welfare programs raises an interesting question: Are there networks operating within ethnic communities which transmit information about particular programs to newly arrived immigrants?

Anecdotal evidence suggests that ethnic communities transmit some information regarding welfare programs to potential immigrants or to newly arrived immigrants. Writing in the *New Democrat*, Norman Matloff reports that “a popular Chinese language book on life in America sold in Taiwan, Hong Kong and Chinese bookstores in the United States includes a 36-page guide to SSI and other welfare benefits” and that the “*World Journal*, the largest Chinese-language newspaper in the United States, runs a ‘Dear Abby’-style column on immigration matters, with welfare dominating the discussion.”

The SIPP data, in fact, reveal a very strong positive correlation between the probability that new arrivals belonging to a particular national origin group receive welfare and the probability that earlier arrivals from that group receive the same type of assistance. For example, if Irish immigrants who resided in the United States prior to 1985 received such programs as SSI and energy assistance, Irish immigrants who arrived after 1985 will also tend to receive SSI and energy assistance. Put differently, the more an ethnic group has been “exposed” to a particular program in the past, the more likely that new immigrants who belong to that group will also participate in that program.

Moreover, this correlation remains strong even after we control for the household’s demographic background (which determines the household’s eligibility for the program) and for the state of residence where the household resides. The magnitude of this correlation is numerically important: A 10 percentage point increase in the fraction of the existing immigrant

stock who receive a particular program implies about a 10 percentage point increase in the probability that a newly arrived immigrant also receives benefits from that program.

This strong correlation may arise because of the existence of networks within the immigrant community, organized along national origin lines. These networks transmit information not only about the availability of income opportunities in the labor market, but also about the availability of income opportunities in the welfare state.

What Have We Learned?

The evidence revealed by the Survey of Income and Program Participation leaves us with three new facts that alter our perception of immigrant welfare use:

1. Immigrant households are much more likely to receive *some* type of welfare benefit than native households.
2. Immigrant households are more likely to be long-term recipients of welfare assistance.
3. There seem to exist information networks operating within ethnic communities which transmit information about the availability of particular types of welfare benefits to newly arrived immigrants.

TABLE 1

MONTHLY PROBABILITY OF RECEIVING BENEFITS IN EARLY 1990s

Type of benefit:	Immigrant households	Native households
<u>Cash programs:</u>		
Aid to Families with Dependent Children (AFDC)	4.4	2.9
Supplemental Security Income (SSI)	6.5	3.7
General Assistance	0.8	0.6
<u>Noncash programs:</u>		
Medicaid	15.4	9.4
Food stamps	9.2	6.5
Supplemental Food Program for Women, Infant and Child (WIC)	3.0	2.0
Energy Assistance	2.1	2.3
Housing Assistance (public housing or low-rent subsidies)	5.6	4.4
School breakfasts and lunches (free or reduced price)	12.5	6.2
<u>Summary:</u>		
Receive cash benefits, Medicaid, Food Stamps, WIC, energy assistance, or housing assistance	20.7	14.1

Source: George J. Borjas and Lynette Hilton, "Immigration and the Welfare State: Immigrant Participation in Means-Tested Entitlement Programs," *Quarterly Journal of Economics*, forthcoming, May 1996.

Chairman DOMENICI. Mr. Tajima, please proceed.

**STATEMENT OF MARK TAJIMA, ANALYST, LOS ANGELES
COUNTY CHIEF ADMINISTRATIVE OFFICE**

Mr. TAJIMA. Thank you. I am Mark Tajima, and I am an analyst in the Chief Administrative Office for Los Angeles County.

After my testimony, I have answers to a number of questions asked of the different witnesses, dealing with public charge bonds and criminal aliens. You were correct. There were only 13 deportations during the decade of the 1980's on public charge grounds.

The basic thrust of my testimony is that issues of immigration and welfare usage are very complex. You were right in saying that there are real distinctions between legal and illegal immigration. Differences often are blurred between the AFDC, SSI, Medicaid Programs, where immigrants' usage is not the same; the patterns of use vary by categories of immigrants, and the relative impacts on different levels of government also vary. The solutions to these problems have major ramifications.

What concerns us at the local level and where in other areas, besides immigration, Congress has been moving in a good direction, is that there are what you would call one-size-fits-all solutions. What you do for illegal immigrants, may not work for legal immigrants, and what works in one program will not necessarily work in another program.

Our bottom line concern in Los Angeles County, which, by far, has the Nations largest immigration population, is that the real burden of most of the cost of services provided to legal and illegal immigrants is borne at the local level. Our county is the only public or private entity that has actually done a comprehensive fiscal study of the impacts of immigration that distinguished the impact of illegal immigration from legal immigration. We divided the immigrant population into three subgroups: illegal aliens; newly-legalized aliens (i.e. former undocumented aliens who were granted amnesty under the Immigration Reform and Control Act of 1986); and recent legal immigrants.

We found that the impacts vary widely between categories of immigrants. One of our major findings also was that, in terms of the Federal Treasury, 60 percent of taxes paid by immigrants goes to the Federal Government; yet again, the costs are mainly borne at the local level.

I believe Senator Frist asked about the impact on health care costs. In Los Angeles County, in order to claim reimbursement under a temporary Federal Program that reimbursed our amnesty health costs, we were able to conduct statistically valid samples of our patients, and found that 25 percent of all patients served at our county public hospitals were undocumented aliens, who accounted for 30 percent of our total unreimbursed health costs.

That was in 1992. In the same year, based on State of California data, illegal immigrants accounted for 6 percent of the State's unreimbursed medical costs, primarily for emergency medicaid services. At the Federal level in 1992, they accounted for only four-tenths of 1 percent of total medicaid and medicare expenditures, a minuscule impact. The reason for this negligible impact is that undocumented immigrants are ineligible for medicare, which is the biggest Fed-

eral health program, and the only medical benefit they are eligible for is emergency medical care, only if they are indigent and categorically eligible, which would exclude single adult males who are not categorically eligible for medicaid.

Illegal immigrants have a much bigger impact at the local level because they are much more likely to be uninsured. There was a national follow-up study of the legalized alien population which found that 50 percent of the newly legalized alien population were uninsured, and with no medicare or limited medicaid coverage, the burden of providing health care to them falls on the local level.

One of our major concerns about denying medicaid to legal immigrants also is the major cost shift to the local level. The courts have generally ruled that the Federal Government can deny benefits to immigrants under their programs, but States and localities cannot under our programs, so immigration in fact is the big mandate on the local level.

One issue that was raised was enforcing deportation on public charge grounds. Our concern with enforcing public charge requirements is a matter of how one prioritizes limited Federal resources. Sure, immigrants use welfare, but do you want to focus on legal immigrants versus undocumented immigrants? To enforce the public charge grounds for deportation, INS would have to somehow get data from public agencies throughout the country on who actually received public assistance, which would not be easy.

A fear we have at the local level, because oftentimes Federal policy has unintended consequences, is that if one simply focuses on their use of Federal public assistance programs such as medicaid, immigrants may not apply for medicaid but will still use local health services, and again, you could have a bigger cost-shift at the local level.

One of the committee members raised the issue of criminal aliens. Again, we would much rather see limited Federal resources going into enforcing laws against criminal aliens, which impose a much, much greater burden on local taxpayers. In Los Angeles County within the past 5 years, the percentage of criminal aliens in our county jail system rose from 11 percent to 17 percent.

With respect to not enforcing immigration laws, there is a law on the books, 8 USC 1326, which makes it a Federal crime punishable by up to 15 years for a criminal alien to unlawfully enter the country. The county did a study which followed over 1,000 criminal aliens removed from the country from our county jail system in 1991. Within the next 12 months, 80 percent were back in the country and had been rearrested.

Again, we would prefer a greater emphasis on strengthened border enforcement to keep criminal aliens out of the country than on using limited resources aimed at enforcing the public charge requirement.

We would hope that you would look at the impacts of Federal policies on local governments. We are very concerned that bars on Federal benefits to immigrants merely shift costs to the local level. It is very easy at the Federal level to deny reimbursement, but at the local level, when people receive direct services, it is hard to verify immigration status and to deem income of sponsors of immigrants when they come into your clinics. Our county hospitals must

deal with 4 million outpatient health visits a year; we cannot verify the status of each of those persons without delaying health care to citizens who are eligible to receive services.

Thank you for the opportunity to testify.

Chairman DOMENICI. Thank you very much, and thanks for coming such a long distance. We appreciate it very much.

[The prepared statement of Mr. Tajima follows:]

TESTIMONY OF MARK TAJIMA
LOS ANGELES COUNTY CHIEF ADMINISTRATIVE OFFICE
Before the Committee on the Budget
United States Senate
on
Immigrants and Public Assistance
March 12, 1995

Mr. Chairman and Members of the Committee, I am Mark Tajima, an analyst in the Los Angeles County Chief Administrative Office. For the past 13 years, one of my areas of responsibility for the County has been to analyze Federal Immigration policies and their impact on the County. I also have served on national and state task forces on Immigration and refugee issues affecting state and local governments.

Let me begin by thanking the Chairman for inviting me to testify on immigration and welfare reform issues relating to the use of public assistance and other human services by immigrants. These issues are of particular importance to the County of Los Angeles. We have the nation's biggest immigrant population and also administer public assistance and other human services programs, such as Aid to Families with Dependent Children (AFDC), JOBS, foster care, child welfare services, Food Stamps, child support enforcement, and general assistance (GA) to needy persons who are categorically ineligible for AFDC and Supplemental Security Income (SSI). In addition, the County's public hospitals and clinics are the health provider of last resort for indigent and uninsured residents.

Before discussing the specific topics which you asked me to address, I would like to make some general remarks relating to Federal Immigration and welfare policies from the perspective of someone who works in local government and who has studied the impacts of immigration and of Federal Immigration policies over the years.

First, there is no panacea for controlling the cost and use of public services by immigrants. The effects of immigration on public services are highly complex and vary significantly by program, by governmental entity, and by category of immigrant. Past trends may not continue into the future. Immigration is not easily controlled by government, as we have seen by the continued high levels of illegal immigration. Just as in the case with welfare policies, there are no easy solutions to problems, and well-intentioned policies can make things worse, not better.

We in local government welcome the enactment of the Unfunded Mandates Reform Act of 1995 which recognizes that unfunded Federal mandates limit the ability of local officials to prioritize and address the needs of their communities. We also welcome the growing recognition in Washington that "one size fits all" policies do not work. It is our hope that, in pending immigration and welfare reform legislation, Congress similarly will be sensitive to the impact of its immigration policies on state and local governments.

It should be recognized that Federal Immigration policies, in effect, have mandated major costs on state and local governments. They are mandates because the Federal government, which has sole authority over immigration, not only controls how many immigrants enter the country, but also decides what rights and services are afforded them. Yet, states and localities must bear a disproportionate share of the costs of services provided to immigrants, as well as executing the "frontline" tasks of making face-to-face, day-to-day decisions on who does or not receive services.

I would stress that many local governments, such as Los Angeles County, cannot absorb major increased costs resulting from new unfunded Federal mandates or immigration policies which shift costs. Because local government budgets must be balanced, budget shortfalls mean cuts in essential services which hurt citizens and immigrants alike. Earlier this month, due to the County's fiscal problems, the County had to reduce its general assistance (GA) grants to legal residents from \$285 a month to \$212.

In formulating policies relating to immigration and the eligibility of immigrants for public services, I, therefore, would urge that Congress take into account the following considerations:

- the potential for shifting greater costs to state and local governments;
- the extent to which the costs of administering new immigrant eligibility, verification, and sponsorship would exceed benefits; and
- the indirect effects of immigrant-related requirements on citizens.

I now will comment on the specific immigration and public assistance issues which are the focus of today's hearing:

Effects of Immigration on Human Service Programs

The quantitative impact of immigrants on human service programs has been a topic of intense debate. In reality, actual nationwide data on the use of human services by immigrants are generally limited to Federal public assistance programs, such as Aid to Families with Dependent Children (AFDC), Food Stamps, and Supplemental Security Income (SSI) for which lawful immigration status is a condition of eligibility and which have automated data systems with which to retrieve selected data elements on recipients. Less definitive information is known about the impact of immigrants on wholly state and local programs. Assessments of the use of services by immigrants, instead, generally have been based on survey data, anecdotal data, or estimates of their demographic characteristics.

What we do know from available studies is that, in general, the effects of immigration on human service programs are complex and vary by program and by categories of aliens. The effects also may vary between states and within states, just as there are variations in the use of public services by citizens and other subpopulations. Some of the generalizations on the impact of Immigration that may be drawn from available data include the following:

- Undocumented aliens are not eligible for open-ended Federal public assistance entitlement programs, such as AFDC, SSI, Food Stamps, and Medicaid (except for emergency care) so their impact on Federal spending is negligible. However, they have a greater relative impact on state and local expenditures, particularly in the areas of health and education.
- The use of public assistance by refugees is much higher than the utilization rate for the general population. Unlike most immigrants who must show that they are unlikely to become a public charge as a condition of entry in the U.S., refugees are exempt from this requirement because their entry is based on whether they have a well-founded fear of persecution. We, as a nation, have deemed their entry to be consistent with our national interests, values, and priorities.
- Other legal immigrants utilize AFDC and SSI at a higher rate than the general population and account for a growing percentage of AFDC and SSI recipients nationwide. Immigrants' utilize SSI at a much higher rate than the general population, but receive Social Security, which is a much more costly program, at a far lower rate than the general population. According to the March 1994 Current Population Survey, non-citizens accounted for 6.0 percent of the total U.S. population, but only 2.4 percent of all Social Security recipients.
- Complete national data is unavailable on the use of general assistance (GA) programs by legal immigrants. However, in a number of counties with large immigrant populations, such as Los Angeles County, legal immigrants represent a significant portion of the total GA caseload. As of June 1995, legal immigrants, excluding refugees and parolees) accounted for 18.6 percent of all GA recipients in the County.

It is important to note that past immigrant welfare trends may not continue into the future. For example, part of the growth in recent years resulted from the one-time impact of legalization provisions in the Immigration Reform and Control Act (IRCA) of 1986, which legalized the status of about 2.7 million undocumented immigrants. In Los Angeles County, the number of legalized aliens on AFDC grew from zero in 1992 to over 50,000 by 1995. It is highly unlikely that there will be another legalization program in the foreseeable future.

Enforcement of the Public Charge Grounds for Exclusion and Deportation

Under current immigration law, aliens, with certain exceptions, must show that they are unlikely to become public charges to be admitted into the country. This public charge grounds for excluding aliens has had some effect in keeping down the use of public assistance by legal immigrants, as evidenced by the fact that refugees, who are exempt from public charge requirements, use public assistance at a much higher rate than those who are subject to those requirements.

It is noteworthy that, while refugees generally have a much greater impact on state and local public assistance costs than any other category of aliens, state and local officials generally have been supportive of refugee resettlement. I know of no state and local elected officials who have called for excluding refugees on public charge grounds. Instead, it has been the concern of state and local officials that the Federal government has not borne its fair share of refugee resettlement costs.

I believe that the public charge grounds for deportation has no effect in deterring use of public assistance by immigrants after they lawfully enter the country. Only 13 immigrants were deported by INS on public charge grounds during the entire decade of the 1980s despite the fact that many more immigrants undoubtedly met the criteria for deportation. However, having said that, there are good public policy reasons for not strictly enforcing the public charge grounds for deportation.

For one, strict INS enforcement of the public charge grounds for deportation would be costly to implement. It would require the INS to collect data on the use of public assistance by immigrants from numerous Federal, state, and local agencies. If, for ease of administration, the INS were to deport only immigrants who used Federal programs, it could result in their increased use of state or local services, adding to state and local costs.

Limited INS resources should focus on deporting criminal aliens and undocumented aliens rather than on law-abiding legal immigrants. Also, without stronger enforcement of employer sanctions laws and improved border enforcement, deporting legal immigrants may have little effect. It merely may result in their illegal reentry in the country.

Affidavits of Support and Immigrant Sponsor Deeming Requirements

Under current law, to be admitted as permanent residents, unless waived, aliens must prove that they are not likely to become a public charge. One way of meeting this requirement is if an alien has a sponsor who signs an affidavit of support attesting to his/her ability and willingness to help support the alien. The courts, however, have ruled that the affidavits of support are not legally binding. In an attempt to make sponsors more responsible, in the early 1980s, Congress enacted legislation to deem (count) a portion of a sponsor's income and resources as being available to the alien in determining eligibility and benefits under the AFDC, SSI, and Food Stamps programs for 3 years. In 1993, the deeming period for SSI was temporarily extended to 5 years.

The precise impact of current sponsor deeming provisions is unknown because the INS does not maintain computerized data on sponsors, their incomes, the amount of support they provide, and the number of sponsored immigrants. There also is no readily available data on welfare usage by sponsored immigrants. Nevertheless, the clear effect of deeming a sponsor's income and resources generally is to make sponsored immigrants ineligible for AFDC, SSI, and Food Stamps during the deeming period. Also, SSI survey data suggests that many immigrants delay applying for SSI benefits until after the end of the deeming period.

It is noteworthy that, from the standpoint of the sponsored immigrant, a major inequity with sponsor deeming is that a sponsor's income is assumed to be available to the immigrant regardless of whether any support actually is provided by the sponsor. This approach fundamentally differs from the Federal approach to child support enforcement in which the goal is to ensure that child support is actually paid by absent parents. In the case of child support, income and resources are not deemed. Instead, only assistance actually provided by absent parents are counted in determining eligibility for welfare benefits.

In deciding how to reform immigrant sponsorship requirements, Congress should consider the experience with child support enforcement as similar issues apply. Two key issues are:

- How much support should the sponsor be expected to provide to the immigrant, and for how long?
- How can sponsors' obligations be enforced in a cost-effective manner? Just as with child support, effective enforcement of immigrant sponsors' obligations will be costly. The costs of enforcement can exceed the costs of collections.

Proposals which merely make the affidavit of support legally binding and which require immigrants and public agencies to enforce sponsorship obligations through the courts are likely to be of little benefit unless they also include enforcement mechanisms similar to the current child support enforcement system. In fact, such proposals can result in a net increase in state or local costs if they lead to the filing of numerous claims in state courts, which already often have backlogs of civil cases.

If sponsorship obligations are to be enforced through the courts, it would be more practical and cost-effective to set up a Federal administrative court to handle such cases. Such a Federal court could develop expertise in handling claims and a common set of procedures which would apply nationally. Moreover, in practice, a sponsor who fails to provide support will be subject to claims by multiple public agencies. It would be more practical to consolidate public agencies' claims against individual sponsors into a single claim, which should be handled by the Federal government. Also, in order for sponsorship obligations to be enforced in a cost-effective manner, the INS needs to establish an automated national registry to track sponsors.

In short, enforcement of immigrant sponsorship requirements should be a Federal, not state or local, responsibility. Any reform in this area needs to be designed in a manner which would not impose added financial burdens on states and localities.

As currently administered under the AFDC, SSI, and Food Stamps programs, immigrant sponsor deeming requirements are neither burdensome nor costly to administer. The administration of sponsor deeming requirements could be enhanced if data on immigrant sponsors, including their Social Security numbers, were incorporated into the existing automated Systematic Alien Verification for Entitlement (SAVE) system, which is used to verify eligible immigration status under Federal entitlement programs, such as AFDC, SSI, Food Stamps, and Medicaid.

Extending the time period for deeming under these programs until immigrants become naturalized also would not impose any significant new administrative burdens or costs. Indeed, one of the effects of deeming is to deter applications from immigrants during the deeming period. However, we are concerned that proposals to extend deeming to immigrants after they become citizens would be extremely burdensome not only for state and local welfare agencies, but also for citizens. This is because it would require welfare agencies to verify whether citizens previously were sponsored, which would not be simple, and which would affect all applicants for benefits.

It is noteworthy that currently only immigrants are asked about sponsors, which means that the vast majority of applicants are not affected. Applying eligibility requirements to citizens greatly magnifies the costs of verification. The added administrative costs not only would affect states with large immigrant populations, such as California, but also states with small immigrant populations. The question needs to be asked whether the benefits of imposing a new Federal welfare eligibility requirement would exceed the added administrative costs. In this case, I believe the answer is no, especially under the AFDC and Food Stamps programs where the assistance unit is families, not individuals.

Implications of Enforcing Sponsor Deeming Versus a Ban on Welfare Receipt By Immigrants

Finally, I have been asked to address the implications of enforcing sponsor deeming requirements versus a ban on the receipt of welfare by immigrants. From a local government perspective, one of our biggest concerns with either proposal is that they could result in a major cost shift to local governments, especially if legal immigrants lose eligibility for Federal-funded benefits, but continue to require local-funded services.

It is important to note that the courts generally have ruled that the Federal government, but not states, has the broad authority to restrict benefits based on alienage. In Graham v. Richardson, the U.S. Supreme Court ruled that state laws that restrict public assistance to legal immigrants violate the Fourteenth Amendment's equal protection clause and encroach on the exclusive Federal power to regulate immigration. State courts in at least two states (Michigan and Rhode Island) also have struck down state laws which deemed immigrant sponsor's income in determining eligibility for state general assistance programs on the grounds that it violated the Fourteenth Amendment's equal protection clause. Therefore, either bans of Federal benefits to immigrants or sponsor deeming can result in a cost shift to state or local governments to the extent that immigrants who are made ineligible for Federal programs would shift onto state or local programs.

Based on Los Angeles County's experience with current sponsor deeming under the SSI, AFDC, and Food Stamps programs, we have not seen evidence of any significant shift of immigrants onto our general assistance (GA) rolls. Our experience, however, may not be representative of most other counties, and I understand that some other California counties have experienced a significant impact.

We believe that barring these Federal benefits to legal immigrants, however, could result in a major cost shift to state and local general assistance programs, especially if aged, blind, or disabled immigrants are denied SSI benefits. By definition, aged, blind, or disabled immigrants never will become self-supporting. In the case of sponsored immigrants, they could receive support from their sponsors, especially if affidavits of support are made legally enforceable. This would not be true of immigrants without sponsors, such as refugees who enter our country fleeing persecution with no financial resources. The financial burden of aiding these immigrants would fall on the communities in which they reside because their needs will not disappear.

There also are pending proposals before Congress which would extend immigrant sponsor deeming requirements or would prohibit immigrants from receiving Federal benefits under non-cash, means-tested programs, including programs in which Federal spending currently is capped or proposed to be capped. We strongly urge that no added restrictions on the eligibility of immigrants (including sponsor deeming requirements) be made under capped entitlement or discretionary programs for which there would be no Federal cost savings. Those new requirements, however, would increase administrative costs, reducing the amount of actual services provided to citizens.

We are most concerned that the denial of Medicaid benefits to either sponsored or unsponsored immigrants would result in a major cost shift to local public hospitals which provide services to all patients without regard to immigration status or ability to pay. Many local public hospitals, including the County's, already are financially distressed. Higher costs could force cutbacks and closures which would endanger the lives and health of all residents, citizens and aliens alike.

It also is noteworthy that it is much more difficult to deny services to immigrants at the local level where many services are provided to recipients at clinics or settings on a walk-in basis. Some of these services are partially funded by non-cash, Federal programs, such as Maternal and Child Health and Title XX Social Services, which would be subject to proposed immigrant eligibility restrictions. Again, requiring immigration status or sponsors' incomes to be verified under such programs would not result in any cost savings to any level of government. Doing so, however, would delay the provision of services to all persons whose citizenship status must be verified before receiving services. These new Federally mandated requirements would affect not only areas with large immigrant populations, but also those with few immigrants.

In conclusion, there is no "one size fits all" solution for applying immigrant eligibility or sponsor deeming requirements to either Federal, state, or local levels. What works in one program in one local jurisdiction may not work in others. For example, immigrant eligibility requirements are more readily implementable under income maintenance programs such as AFDC, Food Stamps, and SSI, which have automated data systems and for which eligibility does not have to be immediately determined, than under non-cash, direct service programs.

In closing, I thank you once again for the opportunity to testify here today. I would be glad to answer any questions you may have.

**NUMBER OF PUBLIC ASSISTANCE RECIPIENTS
IN LOS ANGELES COUNTY BY IMMIGRATION/CITIZENSHIP STATUS**

June 1995

I. Aid to Families with Dependent Children (AFDC)

<u>Immigration/Citizenship Status</u>	<u>No. of Recipients</u>
Refugees/Parolees	73,198
Legalized Aliens ¹	51,966
<u>Other Legal Immigrants</u>	<u>65,149</u>
Subtotal - Non-Citizens	190,313
<u>Citizens</u>	<u>694,308</u>
TOTAL	884,621

II. General Assistance

<u>Immigration/Citizenship Status</u>	<u>No. of Recipients</u>
Refugees/Parolees	999
<u>Other Legal Immigrants</u>	<u>16,882</u>
Subtotal - Non-Citizens	17,881
<u>Citizens</u>	<u>72,882</u>
TOTAL	90,763

¹ refers to undocumented immigrants who were granted legal status under the Immigration Reform and Control Act (IRCA) of 1986.

Chairman DOMENICI. Next, Karen Darner, with the National Conference of State Legislatures.

STATEMENT OF KAREN DARNER, VIRGINIA HOUSE OF DELEGATES, ON BEHALF OF NATIONAL CONFERENCE OF STATE LEGISLATURES

Ms. DARNER. Thank you, Mr. Chairman. I could probably shorten my presentation by saying "Ditto" to Mr. Tajima's remarks.

I am Karen Darner, and I represent part of Arlington in the House of Delegates in Virginia's General Assembly, and I am also here representing the National Conference of State Legislatures today.

I am a teacher in the Arlington schools and will go back to class tomorrow, Virginia just completed a 3-year study on the needs of the foreign-born in the Commonwealth. I also serve as vice chair of a new Immigrant and Refugee Policy Council in the State of Virginia.

My testimony today will be on some of the personal experiences I have had, but also on the positions of NCSL and the bipartisan

efforts that they have with regard to the immigration and welfare reform issue.

I know that all of us are very much in support of balancing the budget, and it is an important concept for the Federal Government as well as the numerous States. And having balanced Virginia's budget at 5:38 p.m. last night when we voted to do that, I understand very well the issues that are at hand for you and other Members of the Senate and the House of Representatives in reaching that goal.

The decisions are very, very difficult decisions, but NCSL believes strongly that removing benefits from legal immigrants with regard to welfare is going to create tremendous difficulties on local and State programs and the services that are provided.

When the Federal Government withdraws some of its financial support, the need for that support has not been diminished whatsoever, and I think the figures that we were talking about earlier with regard to immigration in the United States indicate that.

NCSL believes that the immigration issue is a Federal policy, that the Federal Government is responsible for immigration, and as such, it needs to enforce the rules that they current have in operation.

Over the last 10 years, we have seen a diminution of the funding from the Federal Government with regard to local and State programs that have been started by and also, with the greater number of immigrants coming into our communities, we find fewer and fewer Federal dollars. I think Mr. Tajima indicated that you have a certain amount of tax money that is paid by immigrants that goes to the Federal Government, but the programs that are being provided on the local level are just not getting that funding back from the Federal Government.

This continuation of the welfare reform debate does the same kind of thing. We are looking at trying to pull back some Federal support, and that becomes a difficulty.

There are three main issues that NCSL has. One is the cost-shifts to the State and local governments. It becomes in some regards an unfunded mandate. Also, some of the proposals we have heard appear to have some constitutional challenges that could be made to them, and I think those have been discussed earlier with INS.

And then, when you have an administrative nightmare coming into view with regard to a variety of different categories that you are looking at eligibility for welfare, that becomes a great concern to us as well.

With regard to the shift of costs to the State and local programs, restricting legal immigrant benefits, as I said before, does not take care of the need that is there on the local level. I think all of us agree, and it has been stated by the various members of the committee earlier, that the contributions of immigrants are very important to this Nation, and we are stronger for it; but it also takes time, and in the number of public hearings that we held throughout Virginia, the big issue was learning English, that people want desperately to learn English because they understand that with it, self-sufficiency will be much easier in this country.

We have waiting lists of astronomical numbers in the Northern Virginia area. When you have a mother and father who have come to this country with their family, the kids are learning English because they are in the classrooms with their peers, but the parents may find that they have two or three jobs that they are working, and the course that is available in English may be at a time when they are not able to take that class. Then, they also often have to do it within a 3-month period of time, and I know I cannot learn another language in 3 months and become proficient in it. So that is one of the barriers to moving toward an independent work ethic.

We also find with people learning English that they have less reliance on their sponsors, and that is an important move forward. We agree with you on the need to make the sponsorship affidavits enforceable, that that is just a very critical move with regard to handling this particular problem—but not everybody has a sponsor.

We also know that AFDC eligibility is sort of an entry into being able to use some medicaid. If that were not the case, for many people, access to indigent care, emergency rooms and other situations would occur with regard to health care. There might even be an avoidance of treatment when it is necessary because of the concern that they have of the cost and what might happen to them.

Then you look at it being a public safety issue with regard to health care as well as increasing costs for health care for everyone. In Virginia, we have a Working Poor Women's Program where we are able to provide prenatal care which, in the end, I think we all understand provides for healthy babies. It is a good policy, but under the H.R. 4 provisions, that kind of thing would be eliminated.

Also, if you have a lower proficiency in English, you are inclined to take a lower-skill job which may also be the kind of job that would incur greater injury and/or more frequent injuries, so that again, we are removing the safety net from people with regard to providing this kind of help.

The States are not going to cut people off because they understand that the need is still there; it is an important concept to pursue. Fortunately, we have throughout the Commonwealth of Virginia numerous private and public partnerships that have been established. We have the Office of Newcomer Services, which serves as a transition for these services, and throughout the Commonwealth, programs have attempted to assist people, but as in many instances, they are overextended with regard to filling the gaps that have been presented to them in the past.

NCSL's second concern is the questionable constitutionality of restriction in welfare benefits, and I think we have talked about that with regard to one Supreme Court decision; there was another one in 1971, *Graham v. Richardson*, which said that the States could not deny benefits to immigrants just because they were in the category of immigrant. And now, H.R. 4 may attempt to give the States that responsibility, but that is questionable, and I think we will see some greater costs incurred in suits that would come as a result of that.

And then, last, the administrative burdens on the localities and States with regard to verifying citizenship, verifying sponsorship, length of stay in the United States, and perhaps whether or not

they have a sponsor. Making changes in things that are currently underway is a very difficult problem to handle on the State and local levels, I think. What we are going to find is that for people who are receiving particular services right now, the transition will not be available for them.

From my perspective, I think the deeming will not save any money and will create additional problems. We need to be able to respond quickly and not have to deal with civil revolt in one country or an invasion in another. In my testimony, I have given you a map of the world which shows the children in Arlington and where they are from, and I hope everyone will keep in mind that it is very difficult for us to predict where the next international incident is going to occur that will bring families to our country and children to our classrooms. We have to be able to respond quickly to that and be able to make sure the families can be assimilated and move from one culture to another into what they hope to see as homeland.

It is very important to remember that the immigrants are not welfare-bound; that most of the people do not apply for welfare. There will be those instances where we have to be very careful about what the provisions are—again, going to the concerns that all of us have with regard to the undocumented—but with regard to the documented, I think it is an important issue that we need to keep in the forefront.

I have a number of other instances, but in concern for time, I will dispense with those and can perhaps interject them into the question period.

I think what is also very important is that we are not looking at the fairest for the most in the long run; we are looking at what is just and fair for all, and I think that is the responsibility that we have at the local, State and Federal levels.

Thank you.

[The prepared statement of Ms. Darner follows:]

PREPARED STATEMENT OF DELEGATE KAREN DARNER, VIRGINIA
HOUSE OF DELEGATES

Mr. Chairman and Members of the Senate Budget Committee, I am Delegate Karen Darner of Arlington, Virginia. I appear before you as a representative of the National Conference of State Legislatures (NCSL) and as an active member of NCSL's Immigrant Policy Project. I currently am the vice-chair of the Immigrant and Refugee Policy Council in the Commonwealth of Virginia and have recently completed a three year term as chair of the Joint Subcommittee on the Needs of the Foreign Born in the Commonwealth of Virginia. I am also a school teacher at the Randolph Elementary School in Arlington, Virginia.

I appreciate your invitation to discuss federal welfare reform and immigrants. My statements are a reflection of my personal experience and the bipartisan consensus of my fellow legislators. It takes three quarters of the states to ratify any NCSL policy, so the positions I summarize this morning are truly bipartisan.

Let me start by saying that NCSL supports the goal of balancing the federal budget and we recognize that the federal government must make tough choices in the coming weeks and months to realize this goal. As a state legislator, I understand the difficulties of balancing budgets and the trade-offs that must be made in budget negotiations. In fact, last night I finished working with my colleagues in the Virginia legislature to successfully balance our Fiscal Year 1997 budget.

However, while NCSL supports a balanced budget, we will not support policy changes that shift costs or place unfunded mandates on the states. State legislators are deeply troubled by proposals to finance federal welfare reform by eliminating benefits for legal immigrants.

Mr. Chairman, eliminating federal aid for legal immigrants will not eliminate their needs, and state and local budgets and taxpayers will bear the burden.

NCSL strongly believes that the federal government is responsible for funding its own immigration policy decisions. Because the federal government has sole jurisdiction over immigration policy, it must bear the responsibility to serve the immigrants that it allows to enter states and localities.

Over the last decade, the federal government has abdicated this responsibility. Federal decisions have increased admissions but reduced targeted funding to states and localities for immigrants, shifting the costs to state and local budgets. Now, under intense pressure to balance the budget, the federal government proposes to further reduce its role in assisting legal immigrants by passing sweeping changes in legal immigrant welfare eligibility. For example, under the H.R. 4 conference agreement, most legal immigrants would be barred from the SSI and Food Stamp programs until citizenship. Future immigrants would be barred from most federal means-tested programs for their first five years in the country. All sponsored immigrants would face deeming requirements for most federal means-tested programs until citizenship. "Deeming" is attributing a sponsor's income to the immigrant when determining program eligibility.

NCSL has three major concerns about these proposals: 1) they shift costs to states; 2) they create constitutional problems; and 3) they impose burdensome administrative requirements on states that are an unfunded federal mandate. Mr. Chairman, I will address each point in turn and close

with NCSL's recommendations which secure federal savings and limit cost shifts and unfunded mandates.

CONCERN #1 - Legal Immigrant Restrictions Shift Costs to States

The vast majority of legal immigrants make valuable contributions to this country. They work, pay taxes and serve in the U.S. armed forces. The legislation that established our Virginia Immigrant and Refugee Policy Council puts it well. It states that "immigrants have come to our shores from the beginning, all foreign born, looking for an opportunity to create a safer and better life for themselves and their families, and this country has benefited from their great contributions." In short, immigrants have made this a country of diversity, opportunity and hope and our nation is stronger for it.

However, not every immigrant story is an immediate success. Corporate downsizing, illnesses and disabilities affect immigrants and citizens alike. Immigrants also must contend with a new language. All of these factors make self-sufficiency an elusive goal. NCSL believes that when legal immigrants cannot support themselves, immigrant sponsors must take responsibility for providing support. As the Committee is aware, sponsorship agreements are not legally-binding in their current form. State legislators have long sought the ability to legally enforce sponsorship agreements. To date, all state and local government attempts to sue sponsors as a means of enforcing affidavits of support have been unsuccessful. In the 1969 California State Court of Appeals decision *County of San Diego v. Vilorio* the court held that affidavits of support are unenforceable moral agreements and not contracts. We are pleased to see that most of the pending welfare and immigration bills contain provisions that would permit federal, state and local governments, as well as sponsored immigrants themselves, to enforce sponsorship agreements.

While NCSL supports enforcing sponsorship agreements, we recognize that this is not a complete solution to state concerns about cost shifts and unfunded mandates. The Congressional Research Service has estimated that approximately half of all legal immigrants are admitted without sponsors at the discretion of the US State Department, so many legal immigrants will not have sponsors to rely on. Also, changes in the nature of sponsorship agreements will only make future agreements enforceable and will not enable states to make current sponsors liable for support.

Therefore, NCSL firmly believes that the federal government is responsible for maintaining an adequate safety net that will meet legal immigrants' needs. If the federal government shrinks its safety net, state and local welfare programs will have to catch more people. The elimination of federal benefits for legal immigrants does not change a state's or locality's responsibility to make services available to all legal immigrants.

Cuts in federal SSI eligibility will directly result in increased state and local government costs. Most immigrants who meet the eligibility criteria for SSI also qualify for state and local General Assistance and indigent medical care programs. Because the SSI application process is so long, many states allow SSI applicants to receive GA while they wait for SSI program approval. Delays in SSI approval resulting from program bars or increased deeming requirements will keep legal immigrant SSI applicants on GA rolls longer. Orange County, California is already experiencing this problem as

a result of the increase in SSI deeming from 3 to 5 years. States such as California, with 250,000 legal immigrants on SSI, and New York, with 89,000 legal immigrants on SSI, would be faced with enormous costs to their GA programs.

Decreases in SSI and AFDC eligibility will also make it difficult for legal immigrants to access Medicaid. Currently, SSI and AFDC are vehicles which allow legal immigrants to be eligible for Medicaid. Without this program eligibility, many legal immigrants will not have access to health care. Legal immigrants will be forced to turn to state indigent health care programs, public hospitals, and emergency rooms for assistance or avoid treatment altogether. This will in turn endanger the public health and increase the cost of providing health care to everyone.

Let me give you an example. In Virginia, in my community we have a number of working poor pregnant women whose incomes qualify them for Medicaid. We consider this good policy because they can receive prenatal care and training they need to bring healthy babies to term. We consider it cost-effective because the citizen children they bear are less likely to be born with low birth weight and will not require more costly services in the future. Under H.R. 4, a legal immigrant pregnant woman would be denied Medicaid for prenatal care even though the child she is carrying will be a citizen

You may wonder why states and localities don't follow the federal example and make legal immigrants ineligible for their programs too. There are two reasons. First, without federal, state or local government assistance, there would be few places for legal immigrants to go to receive help. In Virginia, we have developed a successful public-private partnership to help legal immigrants become self-sufficient. The Virginia Office of Newcomer Services works very closely with local governments, employers, and private charities to help legal immigrants make successful transitions into their new communities. I am proud of this partnership that creatively uses all of our community's resources. Each plays an important part.

However, without federal, state and local government contributions, there is no way that churches and charities can make up the difference. This point was made over and over again at Governor Allen's Summit on Community Responses to Welfare Reform last September. At the summit, non-governmental organizations from across the state of Virginia reiterated that their resources are already oversubscribed. They just won't be able to make up federal spending cuts and families will be without assistance.

Let me give you another example. Last year in Arlington, I sat in on an "intake" interview with a family who had just arrived from another country. The father had just been released after 11 years of living in a prisoner of war camp within that country. He was reunited with his wife, and now four teenage children. He was ill. They were disoriented, having been uprooted from their homeland the day after their father was sent back to them. Through skillful and compassionate translation, case histories were completed, and the family was readied for the beginning of their journey from one culture to another... and to a place they would hopefully call "home." What happens if the safety net is removed or diminished? Requiring any form of "deeming" in this instance would endanger the relationship of mother with father, father with children. Imagine if you will how each of us would withstand such a re-entry... even if it were to happen in our own homeland.

CONCERN #2 - Legal Immigrant Restrictions Cause Constitutional Problems

There is a second reason why states won't cut legal immigrants off of their programs and this leads me to NCSL's second major concern with the H.R. 4 legal immigrant provisions. The U.S. Constitution, and in many cases state constitutions, forbid states and localities from cutting legal immigrants off their programs. Unlike the federal government, state and local governments cannot prevent legal immigrants from accessing their programs solely because they are legal immigrants. The 1971 U.S. Supreme Court decision *Graham v. Richardson* forbids states from denying state welfare benefits to legal immigrants solely on the basis of legal status. The *Graham* decision put legal immigrants into the class of people who have faced a history of prejudice and who are entitled to strict scrutiny under the equal protection clause of the 14th Amendment. This means that state governments would have to have a compelling reason for discriminating against legal immigrants when determining their program eligibility. The *Graham* case also ruled that state restrictions on legal immigrant program eligibility unconstitutionally preempt federal jurisdiction over immigration policy.

A number of states also have state constitutions which require them to provide public assistance to all poor individuals, including legal immigrants. For example, Article 17 of the New York state constitution states that "the aid, care and support of the needy are public concerns and shall be provided by the state..." To enact laws which preclude legal immigrants from accessing public assistance would force states with similar constitutional provisions to amend their constitutions.

To date, all state and local government attempts to deem sponsor income have been struck down by the courts. Legally, states do not have the constitutional ability to treat legal immigrants differently than citizens (unlike the federal government which can under its foreign policy powers). In the 1987 Michigan State Supreme Court decision *El Souri v. Department of Social Services (MI)*, the Michigan Supreme Court held that a Michigan policy of deeming for General Assistance was an invalid infringement upon a suspect classification: legal status.

The Congress itself has recognized the potential for cost shifts and unfunded mandates in the H.R. 4 legislation. In response, Congress included language in H.R. 4 intended to protect states and localities from cost shifts by permitting them to deem or bar immigrants from entering state or local programs. However, these federal protections will not prevent states from absorbing federal immigration costs or prevent lawsuits. Any state that attempts to deem or bar legal immigrants will be threatened with lawsuits by the immigrants' rights community and assume a costly and lengthy process of litigation. As with the Proposition 187 litigation in California, it is likely that courts will grant injunctions forcing states to provide access to their programs until a final ruling is reached. It is also possible that the federal protections will be ruled unconstitutional and that states will ultimately be required to serve all the legal immigrants that the federal government has dropped from its programs.

CONCERN #3 - Legal Immigrant Restrictions Impose Administrative Burdens on States

NCSL also opposes the proposal to apply the deeming provision to any non-cash, federal means-tested program. By mandating that states deem for all these programs, the legislation requires states to extend a complicated administrative procedure to more than 60 federal programs. These mandates will require states to verify: 1) citizenship status, 2) immigration status, 3) sponsorship status, and 4) length of time in the U.S. in each eligibility determination for the deemed federal programs. They will also require states to implement and maintain costly data information systems. Deeming for all federal means-tested programs is hard enough for large states with lots of immigrants, but it's truly a bureaucratic nightmare for states like Virginia, or New Mexico, or North Dakota that have fewer immigrants. What value is there in deeming the midnight basketball program in Albuquerque, or the teen pregnancy counseling program in Fargo?

In Northern Virginia we use the federal Community Development Block Grant (CDBG) program to fund community centers and extension services that provide lunch programs, after school tutoring, English classes and recreational sports programs to community residents. With the new requirements to deem all federal means-tested programs, Virginia will have to deem applicants for everything from children's soccer leagues to mobile meals to English classes. The administrative burden would severely restrict the number of services that could be provided through community services. These are all examples where "the perfect has become the enemy of the good."

Mr. Chairman, these mandates are contrary to the spirit of S.1, the Unfunded Mandates Act, because they create an unfunded burden on states and localities. The deeming provision also garners almost no federal savings and should be eliminated as part of the Congressional commitment to eliminating cost shifts to states.

RECOMMENDATIONS

Mr. Chairman, as I conclude with NCSL's recommendations about how to improve the immigrant welfare provisions, I would like to add a final concern. The H.R. 4 immigrant provisions are much more restrictive than they need to be to address the problems that exist. It is very important that our national immigrant policy addresses specific problems with immigrant welfare use and that we don't just throw the baby out with the bathwater. If we brand all immigrants as welfare users, even when only a small percentage ever try to access welfare, we create a climate of tension, ignorance and fear about immigrants.

So it is critical that we address immigrant welfare issues carefully and thoughtfully. No doubt, there are some changes that need to be made. For example, if sponsors agree to provide financial support for an immigrant, they ought to honor their promise and be held accountable if they leave the immigrant in the lurch. NCSL has long supported making sponsorship agreements meaningful by enforcing affidavits of support. To date, all state and local government attempts to sue sponsors as a means of enforcing affidavits of support have been unsuccessful. Another possibility is extending the deeming provisions for cash assistance programs like SSI, so that sponsors pay a larger share of immigrant needs. The point here is that we can make careful,

targeted changes to our welfare policy that address problems, save a substantial amount of federal spending, limit cost shifts to states and yet still protect the neediest immigrants when they need help

There are other targeted changes we can make. NCSL is prepared to discuss these immigrant provisions with you and to work toward careful and effective solutions. As the Congress and the Clinton Administration continue to seek consensus on welfare reform, NCSL urges you to make, at the very least, the following four changes to the immigrant provisions in any future welfare reform bill:

- exempt legal immigrants who are over 75 years old and have lived in the U.S. for at least 5 years and exempt legal immigrants who become disabled after arrival from all program bars and deeming provisions not in current law ("deeming" is attributing a sponsor's income to the immigrant when determining program eligibility -- it has the effect of making almost all sponsored immigrants ineligible for means-tested programs);
- eliminate any new bars or deeming restrictions for the Medicaid program that are not in current law;
- abolish the deeming requirements for all non-cash, federal means-tested programs; and
- maintain child nutrition and WIC eligibility for all immigrant children served under current law.

These targeted changes will significantly reduce the cost shifts and unfunded mandates to states, they will produce substantial savings for federal deficit reduction, but perhaps most importantly, they will preserve a federal safety net for legal immigrants that is meaningful and fair.

On behalf of the National Conference of State Legislatures, thank you for consideration of my remarks. I would be happy to answer any questions you may have.

Table 9
MAP OF MAJOR NATIVE COUNTRIES OF ELEMENTARY AND SECONDARY LEP STUDENTS
September 30, 1994

(Count shown below includes only those countries with five or more limited English proficient students)

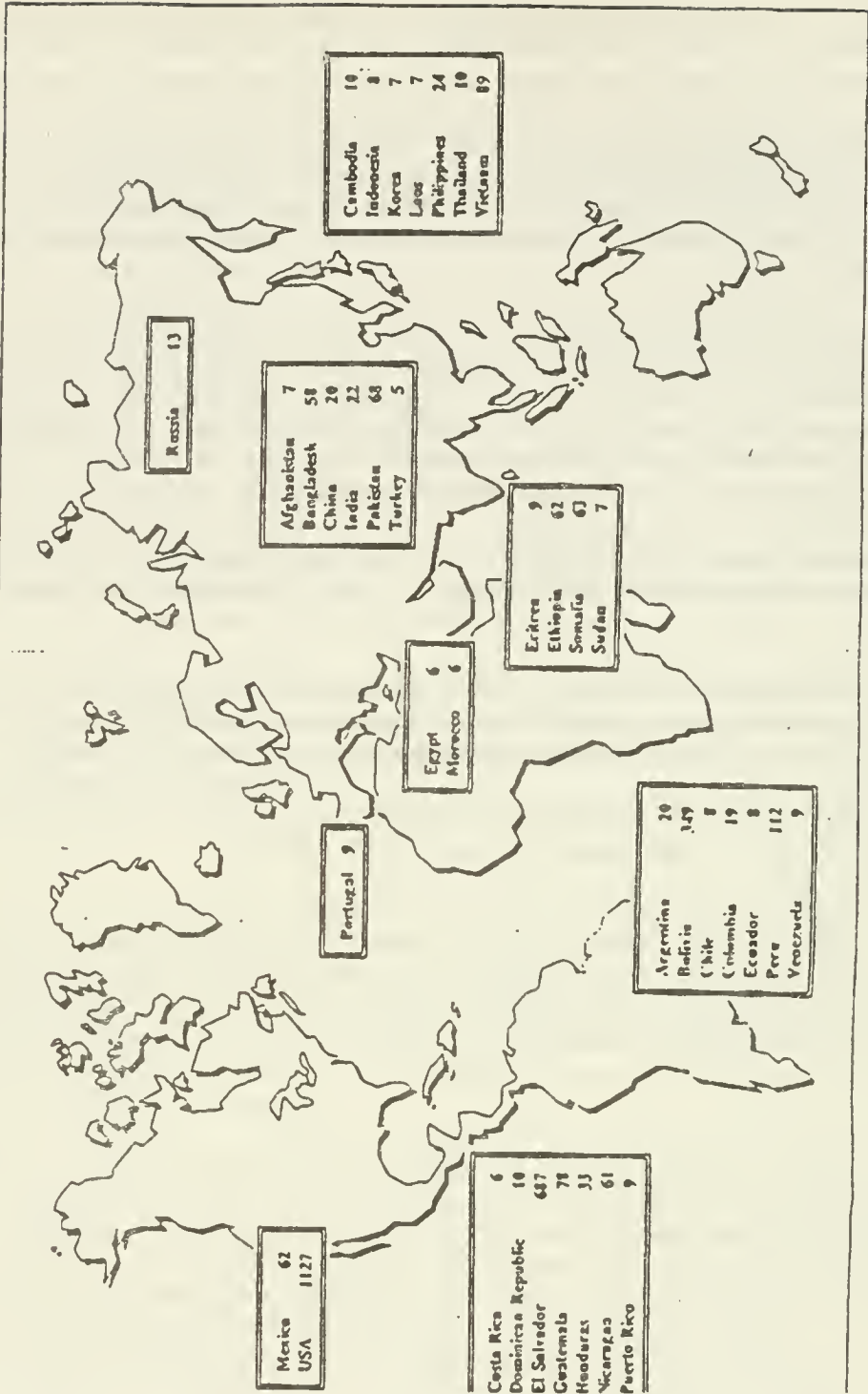


Table 10
 MAJOR NATIVE COUNTRIES OF ELEMENTARY AND SECONDARY
 LIMITED ENGLISH PROFICIENT STUDENTS *
 September 30, 1994

Country	Elementary	Secondary	Total	Percentage
USA	1,105	22	1,127	35.2
El Salvador	220	467	687	21.4
Bolivia	177	172	349	10.9
Peru	57	55	112	3.5
Vietnam	35	54	89	2.8
Guatemala	38	40	78	2.4
Pakistan	46	22	68	2.1
Somalia	31	32	63	2.0
Ethiopia	16	46	62	1.9
Mexico	30	32	62	1.9
Nicaragua	30	31	61	1.9
Bangladesh	29	29	58	1.8
Honduras	11	22	33	1.0
Philippines	14	10	24	0.07
India	12	10	22	0.06
Argentina	14	6	20	0.06
China	10	10	20	0.06
Colombia	11	8	19	0.06
Russia	10	3	13	0.04
Cambodia	9	1	10	0.03
Dominican Republic	6	4	10	0.03
Thailand	8	2	10	0.03
Eritrea	5	4	9	0.03
Portugal	5	4	9	0.03
Puerto Rico	7	2	9	0.03
Venezuela	5	4	9	0.03
Chile	3	5	8	0.02
Ecuador	4	4	8	0.02
Indonesia	3	5	8	0.02
Afghanistan	3	4	7	0.02
Korea	5	2	7	0.02
Laos	1	6	7	0.02
Sudan	5	2	7	0.02
Angola	2	4	6	0.01
Costa Rica	5	1	6	0.01
Egypt	5	1	6	0.01
Morocco	2	4	6	0.01
Turkey	4	1	5	0.01

* Count includes only those countries from which five or more limited English proficient students originate.

Chairman DOMENICI. Senator Grassley, we are very close to adjourning, and if you have any questions or observations, you are welcome to make them.

Senator GRASSLEY. I have no questions, Mr. Chairman.

The reason I wanted to attend this hearing was, frankly, because we are going through a markup on immigration in the Judiciary Committee, and I am a member of that committee.

Chairman DOMENICI. Well, Senator, I think you know that we do not write the law; we raise some very good issues in terms of the fiscal problems that are involved in overall welfare to immigrants, be they legal or illegal.

I do not think we have a lot of time left, but I want to thank you, Dr. Borjas. I think you have provided some real statistical information that perhaps has been lacking. You confirm clearly that the percentage utilization by immigrants and immigrant families is much higher than native-born families in America. You were quick to say that part of that is because of economic status.

And obviously, Mr. Tajima, we are very worried about shifting all the burden down to Los Angeles County; we are not trying to do that, and to our representative in the sovereign State of Virginia, we are not trying to send back things that you cannot afford, but it is pretty obvious that America cannot afford the existing array of welfare programs as they are now provided to immigrants, legal and illegal, and that we have to find some way to make sure that we are not being taken advantage of.

There is a lot of information now that when elderly relatives are coming to America, which is occurring in larger and larger numbers under the family unification concept, it is getting more and more obvious that at the earliest possible time, very large percentages apply for SSI and for welfare benefits.

Obviously, that must put the question in our minds of are we being taken advantage of as a country. We are not anti-immigrant, but we do not have all the money in the world, and the evidence I have seen in just one program, the fastest-growing one around, SSI, immigrants are contributing measurably to that rapid growth. It is part of the statistics we are finding, but in spades in the SSI Program.

So we know that to get our budget under control and to be able to do more things for more people in terms of economic prosperity, we cannot let immigrants, organized or otherwise, take advantage of the system, which seems to be the case in a number of situations.

From my standpoint, I am going to give you some questions to be answered in writing—perhaps 10 days is a reasonable time—and staff will get them to you. I thank you all for your time.

Senator Exon, would you like to stay? I must leave.

Senator EXON [presiding]. Thank you, Mr. Chairman. I will close up.

I have just one question, and then I may have some additional questions for the record.

Ms. Darner, what would schools have to do to apply the bans and the deeming provisions to programs like the School Lunch Program, for example?

Ms. DARNER. I think what would happen in that instance is that, to a certain extent, you would have the school administration or people within the school office serving as the adjunct of the Immigration and Naturalization Service. But also, in some instances, you would find that if it becomes a complicated procedure, they may end up opting out of providing some assistance with the School Lunch Program. I think that that was a genuine concern with regard to several of the States. That is something that is a critical component of programs for children, and we would hate to see that occur.

Senator EXON. Thank you.

Mr. Tajima, I was called out of the room and missed your testimony, but I heard the Chairman say something—I guess you expressed some concerns about this being passed down to the States, and I made a previous statement on that. We cannot just take this problem and say OK, we are going to ban it here and link it to the State of California and Los Angeles County, because I realize that you are overwhelmed on this issue at the present time.

I would just pose a question, and this question would probably have been more properly addressed to Mr. Martin, but we ran out of time. Since all of you have done studies or are familiar with the problems that we have that have been cited today, from your experience, do you agree with the concern that has been expressed here today, starting out with the chart that the Chairman held up at the beginning of the hearing, with regard to what seems to be basic immigration policies that we have stood for in this country, and this country benefitted from for a long, long time—I do not think any of us are trying to stop that—I am wondering, though, if we have not come to the situation where immigration, in all too many cases, as I think was proven beyond a reasonable doubt by the chart that the Chairman held up at the beginning of the meeting, that immigration has become far too much a sight by others seeing their way to the promised land and a fairly liberal welfare means that we have here.

So immigration is not what it once was—a chance for an opportunity in a new land, for me to move freely ahead—but in many instances, I am afraid that it has become an opportunity in a new land for welfare.

Do you people who have studied this agree with that conclusion that I have reached, and if so, how big a problem do you think it is?

Mr. TAJIMA. I would like to comment. When you were out of the room, I made some comments that we have researched in our country the impact of illegal immigration, which you are, of course, very concerned about. We did a major study comparing costs and revenues by different immigrant groups—legal immigrants, legalized aliens, newly and undocumented aliens. As you know, California has more immigrants than anywhere else, and our sense is that there are real differences between types of immigrants which is why we studied different types of immigrants.

We think illegal immigration has the biggest adverse impact on local government. The percentage of criminal aliens in our jails has increased from 11 to 17 percent. Most immigration-related costs are borne at the local level while in terms of the Federal Treasury

overall, our sense is that, particularly with respect to legal immigration, there is a big positive fiscal impact. If anyone should be concerned about immigration, it is local government because we bear more of the costs relative to revenues paid by immigrants.

As an example, SSI is heavily used by legal immigrants, and their usage of SSI has skyrocketed. There is no question of that. But in terms of Social Security, which is a much bigger expenditure item, noncitizens account for 6 percent of the total general population but account for only 2.4 percent of all recipients of Social Security.

We found in our county that 60 percent of all taxes collected by all levels of Government from immigrants went to the Federal Treasury. Much of that, over \$900 million in 1991, was FICA taxes because immigrants tend to be younger and in the labor force. Most of their taxes go to the Federal Government, but most of the financial burden falls on local governments because we fund education and much more nonelderly services. So we think that overall, they have a net positive impact on the Federal Governments in some areas, they contribute a lot to our economic growth. One of their major impacts on our health system is that 50 percent of all undocumented aliens are uninsured. They are working, but they work in small businesses that do not carry health insurance. Those businesses generate a lot of jobs, but local governments incur major costs for health care provided to undocumented workers. So I hope you will make a distinction between different categories of immigrants. Much of the increase in SSI, in my view, is not attributable to sponsored immigrants. Instead, much of the growth was due, in our view, to refugee resettlement, which serves humanitarian purposes and where the number of refugee arrivals go up and down depending on what happens overseas, and also was due to the one-time Amnesty Program, where 2.7 million undocumented aliens were granted amnesty in a very short time period. Now, I do not see that happening again in the next 20 years, but in Los Angeles County, within a 3-year period, the number of amnesty aliens on AFDC went from zero to 50,000. In terms of SSI, the biggest single increase in SSI use by aliens in the last 5 years was from Mexico, which accounted for 20 percent of the National SSI increase. I believe much of that was a one-time impact, due to amnesty. I would caution that, a lot of time, past trends do not continue into the future. When our county's economy improved, the impact of legal immigrants on general assistance recently dropped just like it dropped for the general population.

Immigration is a lot more complicated than some of the Federal welfare reform solutions which would apply one gross policy to all programs when some programs, such as SSI are much more affected by immigration than others. When you make immigrants ineligible at the Federal level, certain services like emergency medical care still must be provided at the local level, or you can endanger citizens by conditioning the provision of emergency care on proof of immigration status.

In closing, some of the immigration status verification requirements would hurt your State or States with very few immigrants, because they are going to have to start verifying where the odds of an immigrant in Lincoln, Nebraska receiving a certain benefit—

you mentioned the school lunch—may be one in 1,000, but you are going to have to screen all of your school children just to identify that one in 1,000. There needs to be administrative flexibility, like in the rest of the welfare programs, to protect against horrendously high verification costs.

Senator EXON. I will get into that now in my last question, and you can all comment on this if you want, but I expect that you, with your experience in a place like Southern California, may have some figures on it.

When you talk about costs, certainly costs for illegal aliens fall right on local governments primarily or the cost-shifting in your hospitals. I assume—and do I assume correctly—that practical all illegal aliens have no health insurance whatsoever. Is that correct?

Mr. TAJIMA. Again, there was a national study done of undocumented aliens who were granted legal status, which found that 50 percent of that group in a statistically valid sample lacked health insurance.

Senator EXON. Fifty percent of what?

Mr. TAJIMA. There really is not good information specifically on undocumented because of the difficulty of drawing a random sample of that population. However, there was a study of the 2.7 million undocumented immigrants who were granted amnesty, which is the best information we have. They drew a sample of 6,200 nationwide, which found about half of the former undocumented population lacked health insurance. There is no reason to believe that the newly-legalized undocumented are different than the others so the estimate of the percentage of undocumented aliens who lack health insurance is based on that study.

Senator EXON. How about legal aliens, or aliens who have come into this country and become citizens—have you ever seen any statistics or a breakdown of what percentage of those people have health care coverage and those that do not?

I would assume that people who come into this country legally and who have become naturalized citizens of the United States of America, that it is very likely that the percentage of that class is not a great deal different than the average native population of the United States. Is that true?

Mr. TAJIMA. Yes; the legal immigrant population is much more likely to have health insurance than the undocumented, although one measure of health insurance when they define it statistically, besides private insurance, is whether you are covered by medicare or medicaid. At least for medicare, because the immigrant population is relatively young, there is a relatively low use of medicare; but again, that means a slightly higher financial burden at the local level. But legal immigrants are much more likely to have health insurance than undocumented.

Senator EXON. Do your studies reveal anything on that, Professor Borjas?

Mr. BORJAS. They do not. I do not have any data on that, no.

Senator EXON. Do you have any opinion on that, Ms. Darner?

Ms. DARNER. Well, it would seem natural that those who had become citizens after coming through the legal channels would be more apt to be in a position to have the medical insurance, but as we know, lack of medical insurance is one of the big problems with

the Nation as a whole. So that as you said, perhaps it would reflect the same proportion.

Also, going back to what I said earlier, if you have lower-skilled jobs, there may be instances where they do not have the insurance. So again, the English proficiency can be linked to that.

Senator EXON. And that is where a lot of those people fall, I would assume.

Ms. DARNER. They would, perhaps temporarily, but it is still going to be a situation where they need some assistance, that is true.

Could I, if I may, Senator comment—you had spoken earlier about the SSI concern, and I think we share that. NCSL has a recommendation for exempting those who are over the age of 75 and have been here for 5 years, as well as disabled, from having some kind of restrictions on their eligibility. I think that that might provide some assistance. Each step that you have in looking at the eligibility requirements will allow us to have some flexibility, and that is something that you all have to determine, I realize.

Senator EXON. I really thank each and every one of you for being here. You have been very, very helpful to us. As you can see, we are very much perplexed about all of this and struggling to do the right thing with a very, very difficult problem.

We appreciate your coming here to help us out, and with that, we are adjourned.

[Whereupon, at 12:08 p.m., the committee was adjourned.]

PREPARED STATEMENT OF SENATOR BARBARA BOXER

Mr. Chairman, I thank you for calling this hearing today on an issue which has particular consequence for the State of California. You have assembled a distinguished group of witnesses and I look forward to hearing from them on this issue.

Today, there are approximately 4 million legal immigrants residing in the State of California. Proposals to restrict legal immigration and Federal benefit eligibility could have an enormous impact on California.

Today's witnesses will describe proposals to reduce the Federal burden such as increasing immigrant sponsor responsibility and more vigorous enforcement of deporting "public charges." There may also be testimony on the need to root out fraud in Federal benefit programs. Like you, Mr. Chairman, I support appropriate measures to eliminate fraud. Most important, Mr. Chairman, I think we must avoid passing the Federal burden onto States and localities.

Immigration legislation currently being marked up by the Senate Judiciary Committee would not bar immigrants from Federally means-tested programs, but would increase deeming requirements for all immigrants—on some circumstances, even for those who have already become naturalized citizens.

Both bills would make the sponsor of a new immigrant required to sign a legally binding affidavit of support. As a general matter, I support the strengthening of the sponsor's commitment to the immigrant they bring to the United States.

Mr. Chairman, last week I met with many supervisors representing local governments throughout California. Do you know what their number one concern was? It was the possibility that these proposals will result in a massive shift of costs to State and local budgets.

Of heightened concern is the fact that the counties with the largest numbers of legal immigrants in the State—Los Angeles County and Orange County—are also those who are the most financially strapped.

If Congress passes proposed legislation to restrict or completely bar legal immigrants from Federal welfare benefits, California counties will be in the position of having to provide their already limited assistance to a substantially higher number of needy people. California counties will see their general assistance rolls skyrocket and their discretionary funds diminish.

I find this ironic coming from a majority that believes the first order of business in the 104th Congress is to pass S. 1, the Unfunded Mandates bill.

Moreover, I think we need to explore not only the shifted burden to States and counties of providing county-funded assistance, but also the new administrative burdens created by expanded deeming requirements.

If legal immigrants will be deemed for potentially all Federally means-tested programs, instead of only the cash-equivalent programs we deem for now—SSI, AFDC, and Food Stamps—this will create a new administrative requirement on the entity which is distributing the assistance. It is important to help these entities with these new burdens.

I think it is also worthy to note that of the approximately 400,000 legal immigrants receiving AFDC in California, about 62 percent of this figure are refugees.

Federal refugee policies recognize the different circumstances of their presence in our country and our policy should continue to recognize these differences.

In conclusion, Mr. Chairman, I want to reiterate my concern about the increased costs and administrative burdens these proposals will have on California.

Thank you.

Prepared Statement of Congressman Xavier Becerra (D-CA)

The Original Intent of Welfare Reform

As President Clinton has often said, the current welfare system is broken and must be replaced. This is true for the sake of the people who are trapped by it as well as the taxpayers who pay for it. When we began to consider reforming welfare, discussions centered on: providing sufficient child care to enable recipients to leave welfare for work, rewarding States for placing people in jobs, restoring the guarantee of health coverage for poor families, requiring States to maintain their stake in moving people from welfare to work, and protecting States and families in the event of economic downturn and population growth.

But current proposals do little to move people from welfare to work. They are burdened with deep budget cuts and structural changes that fall short of real reform. For example, H.R. 4 was designed to meet an arbitrary budget target rather than to achieve serious reform. The legislation makes damaging structural changes and deep budget cuts that would fall hardest on children and undermine States' ability to move people from welfare to work. Making \$60 billion in budget cuts and massive structural changes which puncture the safety net in a variety of programs, including foster care and adoption assistance, help for disabled children and legal immigrants, food stamps, and school lunch is not welfare reform.

With regard to legal immigrants and welfare use, my testimony will point out several important facts: 1) severe and unnecessary cuts to immigrant benefits were made in the conference report; 2) the Democratic compromise bill recognized that some access to benefits by legal immigrants could be altered in the name of welfare reform while preserving fairness and protecting the most vulnerable; 3) cuts are not warranted based on the evidence of use of benefits by immigrants, which is low; and 4) immigrants make valuable and lasting contributions to our society.

The Conference Agreement and the Democratic Position Compared

The conference agreement on welfare reform and the Democratic position are vastly different in their treatment of legal immigrants.

The Conference Agreement

The conference agreement is especially hard on poor legal immigrants. Illegal immigrants are already ineligible for virtually all federal benefit programs.

Low-income legal immigrants would be denied aid provided under major programs such as SSI, Medicaid, and Food Stamps, as well as assistance provided under smaller programs such as Meals-on-Wheels to the homebound elderly and prenatal care for pregnant women. In certain areas, the immigrant provisions of the conference agreement are more severe than those of either the House or Senate welfare bills.

Among the most severe provisions are those that would affect the ability of poor elderly and disabled immigrants to receive SSI. Nearly half a million current elderly and disabled beneficiaries who are legal immigrants would be terminated from the program. They could qualify only after they became citizens or worked for ten years. For many poor immigrants who are old or disabled and can neither work nor, given their age or physical or mental condition, learn all that is necessary to obtain citizenship, this is tantamount to a lifetime denial of benefits.

The food stamp restrictions are equally severe. Both the House and Senate bills would have permitted food stamp benefits to continue for those legal immigrants who have been in the United States at least five years and are either 75 years of age or older or too disabled to naturalize. The conference agreement, however, makes most legal immigrants who are 75 or over or too disabled to naturalize ineligible for food stamps. They would be made ineligible for SSI as well.

These severe SSI and food stamp restrictions affect many legal immigrants with no other sources of support, for example, poor elderly and disabled immigrants whose sponsor has died or become impoverished. Child nutrition programs, including school lunch, and prenatal care are included in the list of banned programs.

The Democratic Compromise

The following provisions were made part of the Democratic Substitute to the House Welfare Reform Bill. The Democratic substitute was supported by every Democrat in the House. The Democratic substitute's immigrant provisions would make two significant changes in current law treatment of legal immigrants' access to federal welfare benefits.

First, the Democratic substitute would require that all family-based, employment-based, or diversity-based legal immigrants have a sponsor execute on their behalf a legally binding affidavit of support before they could be admitted to the United States or before they could have their status adjusted to that of a Lawful Permanent Resident. The affidavits of support would be enforceable against all federal, state, and local means-tested cash benefits.

Second, the Democratic substitute would extend sponsor-to-immigrant deeming in the AFDC, Food Stamp, and SSI programs until an immigrant attains citizenship. (Deeming requires that an immigrant's sponsor's income be considered as part of the immigrant's income in determining the immigrant's eligibility for benefits.)

Several classes of legal immigrants would be exempt from the sponsor-to immigrant deeming provisions. The exempted classes of immigrants would be:

- Legal permanent residents who are 75 years of age or older who have resided in the U.S. for five or more years;
- Veterans, active duty service members, and their spouses and minor children;
- Victims of domestic violence; and
- Legal permanent residents (and their spouses and minor children) who have paid self-employment or social security taxes in each of 20 different calendar quarters.

Immigrants and Actual Benefit Use

The readiness of many observers to believe that immigrant net public sector costs are high is due at least in part to the myth that immigrants are heavy users of welfare. Many believe that both legal and illegal immigrants are drawn to this country by the lure of the "welfare magnet." In fact, many immigrants, including most recent arrivals, are prevented from receiving most forms of welfare or public assistance:

Undocumented immigrants are eligible for very little public assistance except for emergency medical care under Medicaid and Women, Infants and Children (WIC) program benefits.

Immigrants who legalized their status under the Immigration Reform and Control Act of 1986 are barred from most federally-funded public assistance programs for five years after legalization.

Immigrants granted temporary protected status under the Immigration Act of 1990 are barred from most federal benefit programs.

Lawful permanent residents are effectively barred from receiving most cash assistance during their first three years -- and in some cases five years -- in the country. Because their sponsor's income is "deemed" to be theirs during this period when determining eligibility for benefits.

The statistics on welfare use among immigrants reflect the effectiveness of these restrictions. According to research completed by the Urban Institute, among non-refugee immigrants of working age who entered during the 1980s, 2.0% report welfare income versus 3.7% of working-age natives. This difference is quite substantial, particularly in light of the relatively low incomes of these recent immigrants. Among longer-term immigrants of working age, 3.2% are on welfare, still below the proportion of working-age natives on welfare.

While welfare use among refugees is higher, there is a strong practical and ethical case for providing them support upon arrival. They are fleeing persecution, their departure is unplanned, and they arrive often traumatized by war. By sheer definition, these immigrants seek refuge.

Legal Immigrant Use of SSI

While it is true that noncitizen use of SSI has increased substantially over the last twelve years, it is important to note that immigrant use of SSI is not spiraling out of control. In fact, the rate of increase peaked in 1991 and is now at its lowest level since reliable statistics started being collected in 1982. Statistics also show that the noncitizen proportion of the SSI applicants has also been declining since 1990, from 8.2% in that year to 6.8% in 1994. Finally, the absolute number of applications by noncitizens declined last year for the first time by 3.5%.

The Contributions of Legal Immigrants

While little work has been done on the contributions of immigrants, a recent study by the Urban Institute compiled an impressive array of factual data which shows that contributions of immigrants to the U.S. economy are substantial. It becomes clear that immigrants are not a burden to this country and in fact create significant wealth and opportunities.

Research has shown that immigrants create more jobs than they themselves fill. One of the most positive employment effects of immigration is the retention of industries that would otherwise have moved overseas. If no Mexican immigration to Los Angeles had occurred between 1970 and 1980, for example, 53,000 production jobs, 12,000 high paying non-production jobs, and 25,000 jobs in related industries would have been lost.

Another source of job creation is the entrepreneurial activities of immigrants themselves. In 1990, almost 1.3 million immigrants were self-employed, a rate higher than natives.

Regarding spending habits, immigrant spending ripples through the economy, creating jobs and generating revenues for businesses and governments. Total immigrant income in 1989 -- \$285 billion according to the 1990 census -- represented about 8% of all reported income, equal to immigrants' share of the population (7.9%). Even recent immigrants with their relatively low earnings had an aggregate income in 1989 of \$80 billion.

Other nonquantified benefits of immigrants include the job-creation effect of the newspapers, magazines, and radio and TV stations serving immigrant communities. Also, in cities throughout the country, immigrants are credited with reviving once-abandoned commercial areas and with revitalizing entire neighborhoods.

Finally, and importantly when considering receipt of benefits by immigrants, immigrants are net contributors to the tax base. In aggregate, immigrants pay \$25 billion more annually than they receive in benefits according to an Urban Institute study.

Conclusion

Provisions in the welfare reform bills which were passed by the House and the Senate would restrict eligibility to Medicaid, food stamps, SSI, AFDC, and other federal programs to legal immigrants. Such a move turns back the clock to a darker time when people in America, but only certain people in America, lived and worked under the shadow of second class status.

There is no justification for targeting immigrants who do not abuse the welfare system. Immigrants work hard, play by the rules, pay taxes, and serve in the military at America's calling. Most immigrants are long-term residents who have lived in this country and paid taxes for ten years or more. Immigrants do not come to this country to take advantage of our welfare system. On the contrary, studies indicate that non-citizens are less likely to use welfare than their citizen counterparts.

As the Governors may have realized when they decided not to ban immigrants from welfare receipt in their welfare proposal, some immigrants will still experience personal hardships. When the federal government reduces its contributions for caring for the needy, including those legally in our country under laws enacted by Congress, those individuals' needs do not disappear. Instead, the burden is simply shifted to States and local communities. As a result, not only will immigrant families suffer. State and local governments will suffer the sight of their immigrant residents paying federal taxes to Washington (none of the so-called reform proposals relieve immigrants from paying taxes for services they are being denied) and Washington failing to return a fair share of those immigrant-generated tax dollars to the location of their creation.

I hope that the testimony received today will help to inform the debate and will make clear that cutting benefits to immigrants is not welfare reform, rather it is a budget-cutting measure that is certain to adversely impact immigrant children, immigrant families, and States and localities where they reside.

I thank the Committee for allowing me this opportunity to provide testimony and stand ready to assist as consideration of this matter continues.

BUDGET AND ECONOMIC IMPLICATIONS OF ALTERNATIVE SPECTRUM USE POLICIES

THURSDAY, MARCH 14, 1996

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:08 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Gramm, Snowe, Exon, and Conrad.

Staff present: G. William Hoagland, staff director; and Jim Hearn, senior analyst for government finance and management.

For the minority: William G. Dauster, democratic chief of staff and chief counsel; and Soo Jin Kwon, analyst for commerce, transportation, and banking.

OPENING STATEMENT OF CHAIRMAN DOMENICI

Chairman DOMENICI. Good morning, everyone. To the witnesses, I am sorry that we have to put you all there at one time, but we have votes around noon, and so we want to hear from everybody. We are going to limit your time and then have questions.

I thank the Senators who are here, and I must just say Senator Exon is running a bit late but will be here. A number of other Senators have indicated they are going to come by.

This is a very, very important issue for the American people. Some even say that the issue is as big as a question: Are we going to stop having free television in the United States in the near future? Will there be no free television available to anyone?

There are a lot of other ramifications, but I want to welcome the witnesses to this hearing. This obviously deals with the nexus between complicated public policy proposals to auction certain parts of the electromagnetic spectrum and the impact those proposals would have on the Federal budget.

Let me review just a very quick history. Last year the historic balanced budget resolution, adopted by this committee and later by the full Congress, included an assumption that the FCC would raise \$14 billion in additional receipts from the use of the spectrum.

The Commerce Committee, in complying with the budget's reconciliation instruction, examined the various auction proposals, and in the end the committee exceeded the target with a spectrum auction package of about \$15.3 billion over the next 7 years, without addressing the broadcast spectrum.

In today's testimony, CBO will tell us that they have re-estimated the level of receipts from that package, and now their estimates have gone up slightly to \$19 billion. Unfortunately, we all know that that balanced budget proposal that went down to the White House was vetoed by the President.

In the budget discussions that followed at the White House, the President submitted a new budget submission, and the Administration avoided savings in certain entitlement programs. And I am not arguing that point. But they increased receipts from the spectrum auctions to still try to achieve a balanced budget. That target the President submitted to us of auction receipts has grown from \$28 billion to \$32 billion over 7 years, as included in the February 5 budget submitted by the President. This is more than double the savings assumed by the Congress and sent to the President in the balanced budget bill that was sent to him.

Today this committee will address what the broad policy questions are related to these various spectrum estimates. Today we will try to understand the current plan of the FCC to manage a transition from existing broadcast television technology to a new technology.

With this information, we may be able to better understand what it is the Administration proposes when it says it will accelerate—and I use their words—"accelerate" this process. What is the budgetary impact of that? And whom would it affect the most?

Further, we want to examine alternative approaches to that latest plan. Are there significant differences in their effect on the budget? What would the different effects be on various parties, such as rural broadcasters? We might even wonder about some small broadcasting institutions such as the Spanish language broadcasters. Do they have different considerations than urban broadcasters? Who would pay? Who wouldn't? Are there other approaches worth examining that are not yet on the table?

This committee is charged with putting together another budget blueprint for the upcoming fiscal year. The answers to the questions today will guide our thinking as we revisit the budgetary savings in this area.

To lay the groundwork and to understand the various budget numbers, we will first hear from David Moore, Senior Analyst at the Congressional Budget Office, a non-partisan agency that provides budgetary estimates for Congress. We have to this point decided on almost every matter in controversy that we accept CBO's estimates, not OMB's, the executive branch, or some group of economists. It is just to maintain consistency, and we have found that that consistency has served us fairly well considering the difficult estimating jobs that this budget presents for anyone. CBO's numbers, they have given them to us in the past. We will hear them again today.

Then we will hear about the Administration's proposal from Larry Irving, Assistant Secretary of Communications and Information at the Department of Commerce.

Speaking for smaller broadcasters are Mike Burgess, the General Manager of KOB-TV in Albuquerque, and Howard Shrier, president-elect of the Nebraska Broadcasters Association. If anyone is

wondering why, this Senator is from Nebraska, and this Chairman is from New Mexico.

In any event, we did not call you only because of these States, but we think you have some very typical problems to discuss with the committee that might apply in various areas. Perhaps even with the variety of things that exist in Texas, your concerns may even apply to Texas. If you pay attention, Senator, you might find out about that, too, Senator.

In any event, we thank all of you. This is a distinguished group of witnesses, and then we have in addition Tom Hazlett, Director of Communication Policy at the University of California, Davis, and Visiting Scholar at the American Enterprise Institute. Then we will also have Jerry Hausman from Massachusetts Institute of Technology, who is preparing a study on this spectrum, and we are glad to hear from him also.

Now I would yield to you, Senator. Would you like to speak on behalf of Senator Exon at this point?

OPENING STATEMENT OF SENATOR CONRAD

Senator CONRAD. Just very briefly, and I wouldn't presume to speak on behalf of Senator Exon. But I would like to say that as a representative of a rural State, as is the Senator from Nebraska, we have significant concerns with the various proposals that are out there, proposals that are pending, both proposals that have been endorsed by Senator Dole to have an auctioning of the second channel, which broadcasters in my State say would threaten the future of free television in the sparsely populated regions of our country; that there is just no way that they could take on that additional expense when they are already going to be confronted with significant additional expenses of converting to digital. So I think it is critically important that we deal with that issue.

Second, we also have a proposal from the White House that talks about speeding up the auction of the analog. And that is also a concern in various parts of the country, certainly in the part of the country that I represent. But I think that is a concern that is broadly felt, because if you shorten the time from 15 years to 9 years, that puts pressure on consumers, because they are going to have to buy a new television set in order to receive digital. And if we shorten the period of the auction, that transition time is shortened, and the time within which consumers would be expected to make the change would be shortened.

So I think there are major issues that need to be confronted here today and understood. There is an ongoing effort to achieve a balanced budget. I am strongly supportive of that effort. I am involved in a group of about 20 Senators—10 Democrats, 10 Republicans that are working on a balanced budget plan, and we have been grappling with the issues raised by spectrum auction.

I think it is fair to say that the more one digs into it, the more difficulties one finds with the notion of additional spectrum auction, because either enormous pressure is going to be put on broadcasters, especially broadcasters in more remote areas of the country, or we are going to see additional pressure be put on consumers. And, frankly, I don't think any of us here really wants those

results. I think those would be unintended consequences. But we need to understand that as we proceed.

I thank very much the Chairman for holding this hearing today. I think it is very valuable and very timely.

Chairman DOMENICI. Thank you, Senator, and I also want to commend you and the bipartisan group that is working diligently on a proposed balanced budget. I have done my share, with good luck. Who knows? We might even find ourselves working together—trying, anyway. It would be great to have 10 or 15 Democrats join in the balanced budget in the Senate. It might be more difficult for the President to do anything other than to sign that. It might be difficult for him to veto it.

Senator Gramm, thank you very much for coming, and I always appreciate what you say, because you will get right to the point. I know you are a great free enterpriser, and I assume you have some concerns, just like I do, about this.

OPENING STATEMENT OF SENATOR GRAMM

Senator GRAMM. Mr. Chairman, let me thank you and I want to thank members of our panel. I think the driving force behind the whole spectrum debate is that Congress is trying to violate the basic principle that you can't go to heaven unless you die first. And I think basically what we are seeing here is an effort to claim a balanced budget without having to make any kind of tough decision.

So Congress came up with the idea of the \$15 billion spectrum auction, and not to be outdone, as our President is seldom outdone, he said, well, if we can get \$15 billion, why don't we get \$28 billion or \$32 billion? And it seems to me that what we have got to do is to understand exactly what the impact of our actions will be.

We have pioneer stations all over the country that built up the value of their spectrum. They invested money based on an existing system. To come in now and to change that system is going to have a profound impact on the primary mode of communication and entertainment in America, and that is television.

I think that one of the things that is missed in this whole analysis is the ability to extract money or the capacity to broadcast a signal is limited by the cost of using the spectrum. But in that transition, you are going to move from free television to pay television. And I think we are heading that way very rapidly already, and I think it is a thing that we need to understand.

Finally, it seems to me that there is a middle ground here which could be reached. We have had tremendous technological change. We are going to be moving to digital high-definition television. That is going to free up spectrum, but the problem is, as people are broadcasting the old signal and the new high-definition signal, they are going to need the entire broadcast spectrum. But over time, as that transition occurs, there will be spectrum that is freed. And when that spectrum is freed, I think that we ought to auction it.

But I think that we have got to find that logical middle ground that allows the pioneer stations who built a following on their spectrum to keep the part of the spectrum they need to provide the service that they are providing or the service that the technology is about to take us to.

I think that is probably where we want to end up. That is the point I seek. And if we can do that, we will have served the public well.

A final point, Mr. Chairman. Spectrum auction is not the solution to the deficit problem. This is a one-time deal that probably in the end is going to net us \$10 or \$15 billion over time. But it is a one-time deal. And as we all know, if you are going to deal with the deficit, since we spend money every single year, if something is not recurring, all we are doing is making it easier for 1 year, and the biggest reason we are here—we meet every year, we always have the same problem—is we are always putting off hard decisions.

This is not a hard decision, and as a result, it is not going to solve our problem.

Chairman DOMENICI. Thank you, Senator. Your concern about having to die before you go to heaven, I didn't—

Senator GRAMM. I want to escape it myself. It is just I haven't been able to figure out how to do it.

Chairman DOMENICI. But I didn't think that balanced budget was easy. A lot of people died getting there. So we just have—

Senator GRAMM. No; but when you are going for \$15 billion painlessly to \$28 or \$32 billion painlessly, that—

Chairman DOMENICI. That is a pretty big ticket item.

OK. Let's follow the rules. We are going to start with David Moore. We are going to go right down to Larry Irving, Mike Burgess, Howard Shrier, Jerry Hausman, and Tom Hazlett.

If you have prepared statements, they are going to be made part of the record. We have done that. You don't have to ask us to. That is accomplished at this point. If you will, take 10 minutes to summarize what you have given us. If you absolutely can't get it done, we will sense that with you as that red light goes on, and we may give you another extra couple of minutes. Let's start.

Mr. David Moore, Senior Analyst, Congressional Budget Office.

STATEMENT OF DAVID H. MOORE, SENIOR ANALYST, CONGRESSIONAL BUDGET OFFICE; ACCOMPANIED BY PERRY BEIDER, NATURAL RESOURCES AND COMMERCE DIVISION, CONGRESSIONAL BUDGET OFFICE

Mr. MOORE. Mr. Chairman, members of the committee, I am pleased to appear before you. I am joined by Dr. Perry Beider, also of the Congressional Budget Office's (CBO's) Natural Resources and Commerce Division. Today I will discuss CBO's estimates of the receipts that might be generated by two proposals that would modify or significantly change the Federal Communications Commission (FCC) proposal to introduce digital technology to local television broadcasting. For simplicity's sake, I will refer to those proposals as Option I, technically known as the Analog Return Proposal, and Option II, sometimes called the Second-Channel Auction.

My testimony today makes three points:

First, auctioning licenses to use the spectrum is making a substantial contribution to Federal receipts. The Congress may choose among many different options to maintain that stream of receipts in the future.

Second, the proposals discussed here today will lead to different allocations of a valuable part of the radio spectrum. The most important factors in choosing a course for the future are that the ultimate allocation of spectrum produces the most value for society and that the benefits of transition be equitably shared among broadcasters, viewers, and taxpayers.

Third, the uncertainties involved in estimating spectrum receipts make CBO's estimates of the two options so close as to be indistinguishable.

The Omnibus Budget Reconciliation Act of 1993 (OBRA-93) allowed the FCC to auction licenses to use the radio spectrum. Winning bids from the first eight auctions will total more than \$18 billion. It is not surprising, then, that FCC auctions—and not exclusively prospects involving television—are featured in most balanced budget plans.

The vetoed Balanced Budget Act included provisions that both CBO and the Office of Management and Budget (OMB) estimated would generate \$15.3 billion over a 7-year period. The subsequently introduced coalition budget added Option I—the proposed Analog Return—to the auction provisions of the Balanced Budget Act. OMB estimated that Option I would add receipts of \$13 billion, whereas CBO estimated only \$6 billion. In the heat of budget negotiations, \$7 billion is a big difference. But in the uncertain world of spectrum auction receipts, affected by investors' assessment of market conditions, rapidly changing technologies, the progress of deregulation in the larger telecommunications industry, and the FCC's decisions, one should view the CBO and OMB estimates as being closer together rather than farther apart.

To date, receipts have been higher than CBO estimated. For example, CBO's 1993 estimate for 5-year receipts to the treasury, generated by FCC auction, was \$7.2 billion. CBO's December 1995 baseline will estimate that the receipts for that 1994–98 period will be about \$11.7 billion. When we update our figures again to reflect the most recent auctions, we will increase that figure even more.

The estimates that are provided today for the alternative approaches to the transition to digital television are no more certain than those that were offered in the past. Thus, in choosing between proposals, the Congress should not attach great significance to the small differences between the receipts that different proposals might generate.

The remainder of my testimony today will provide some background on the impending changes in the television industry, describe Options I and II, present CBO's most recent estimates of the receipts that each might generate, and briefly explore some other considerations related to the proposals.

The FCC proposes to provide each holder of a current analog broadcasting license with an additional 6 megahertz slot, available within the 400 megahertz of spectrum already allocated for broadcasting through the agility of digital technology.

During the transition period of about 15 years, broadcasters will offer programs in both slots, thus permitting viewers time to adopt the new technology. If broadcasters chose to use a part of their digital spectrum for services other than advertiser-supported television—for example, local paging—the Telecommunications Act of

1996 requires them to pay a fee based on the price paid at auction for licenses to provide similar services.

At the end of the transition, broadcasters would stop transmitting the analog signal and would return that spectrum to the FCC to allocate for other uses—for example, additional cellular telephone service. According to preliminary analysis, between 130 and 150 megahertz of spectrum—commercially attractive large blocks—would be available for auction after the 15-year transition period. CBO has not estimated how much these frequencies might generate at auction 15 years in the future.

Two prominent proposals would either modify or significantly change the FCC's longstanding proposal. Option I, the analog return proposal, would accelerate the FCC's plan to auction the returned analog spectrum, but not auction licenses permitting digital television broadcasting. Option II, the second-channel auction, would auction the new digital slots but would not free up spectrum for non-broadcast uses.

Option I puts into law major elements of the FCC's proposal, but differs by limiting the transition period to 2005 and auctioning the rights to use new spectrum in 2002—3 years before the winning bidders could use that frequency.

Option II, the second-channel option, also begins by creating a number of new digital slots equal to the number of analog channels currently licensed.

As early as 1997, the new digital slots would be auctioned to the highest bidder. The winners would be required to offer a minimum amount of advertiser-supported broadcast service, but would be otherwise free to put excess capacity to any use that did not interfere with the rights of other license holders.

Analog broadcast licensees could continue to broadcast indefinitely and would be permitted to buy a digital slot without selling their analog channel. To that end, legislation would have to specify relief from current limits on station ownership. Current licensees could also choose to convert their analog license to a digital license after a period of time and notification to their service area.

CBO estimates that, as part of a package similar to the coalition budget, auctioning the analog spectrum could add about \$11 billion to receipts in 2002. The estimate is higher than the \$6 billion estimate made in December for the same proposal because new data from the FCC auctions point in that direction.

CBO's estimates of receipts from future spectrum auctions assume that large blocks of contiguous spectrum under 3 gigahertz are valuable. CBO assumes, however, that the value of such spectrum will fall from recently observed levels as more is brought to market. Increased supply will permit increased competition. Competition will decrease service prices, profits, and eventually the prices that bidders are willing to pay at auction.

Turning to Option II, CBO has estimated that auctioning all of the new digital slots in 1997 would increase receipts by a total of \$12.5 billion. The estimate is based on a financial model of the digital broadcasting industry, which assumes that new digital channels would present the first opportunity to enter local digital television broadcasting and that the licensees would use them primarily to

provide four streams of advertiser-supported programming and, secondarily, some viewer-supported services.

Other methods yield higher and lower estimates of receipts from a second-channel auction. The FCC calculated the commonly heard figure of \$70 billion, for example, by extrapolating the per-person, per-megahertz price received for regional paging licenses. No connection exists between that market and the television market, however. Hence, those prices have little, if any, relevance to a second-channel auction.

The FCC also analyzed data on sale prices, advertising revenues, and depreciation costs of current TV stations and obtained second-channel estimates in the range of \$23 billion to \$38 billion. Those data, though more germane, are still difficult to relate to the value of digital channels, which will not be viewable until consumers acquire digital television sets or set-top boxes.

The recent acquisition of a slot for direct broadcast satellite service (DBS) provides another relevant comparison, one that yields dramatically lower estimates of potential receipts. Although DBS is not perfectly comparable to local digital broadcasting, a simple calculation based on the capacity of the DBS slot suggests that MCI's winning bid of \$682 million might correspond to second-channel receipts on the order of a few hundred million dollars.

CBO's estimates of the auction receipts from the options—\$11 billion for Option I and \$12.5 billion for Option II—are so close as to be essentially indistinguishable, given the uncertainties involved. Accordingly, if the Congress wishes to choose between the two proposals, it may want to make the choice on other grounds, such as their total contribution to the Nation's economy.

One reason to think that Option I might make a larger economic contribution is that it allows the FCC to reclaim the channels occupied by today's television stations and repack the digital channels, thus creating sizable blocks of nationwide clear spectrum for new uses. All other things being equal, large blocks of spectrum should be at least as valuable to the economy as small blocks because they allow a larger set of potential uses.

Option I may also be more hospitable to the development of high-definition television. The knowledge that analog sets will have to be replaced or adapted by a certain date might give a critical mass of consumers an incentive to upgrade to high-definition television sets. Conversely, an inefficiency associated with Option I is that it forces all broadcasters to make the transition to digital at roughly the same pace, regardless of the circumstances in local markets.

Similarly, Option I forces viewers to choose between adapting and losing service on each analog TV set by a nationally determined date. Some households might otherwise prefer to continue receiving analog signals on some of their sets until those wear out.

In contrast, Option II does not reclaim the analog channels, thereby relinquishing the opportunity to create valuable blocks of nationwide clear spectrum.

Chairman DOMENICI. How close are you?

Mr. MOORE. I am coming home. [Laughter.]

Chairman DOMENICI. All right.

Mr. MOORE. A possible advantage of Option II is that it can easily be modified to reduce the number of channels auctioned if congestion becomes a problem.

In conclusion, CBO's estimates of auction receipts from the Option I analog return and Option II second-channel proposal differ by a relatively small amount, given the uncertainties involved. CBO estimates that either proposal or, for that matter, the FCC's proposal would eventually generate substantial receipts. The Congress' action on television transition proposals will have important implications for the efficient use of the spectrum and the welfare of television viewers and broadcasters. Those effects deserve to be the focus of the Congress' decision about the future of television broadcasting.

Thank you, Senator.

Chairman DOMENICI. Thank you very much.

[The prepared statement of Mr. Moore follows:]

PREPARED STATEMENT OF DAVID H. MOORE, SENIOR ANALYST, NATURAL RESOURCES AND COMMERCE DIVISION CONGRESSIONAL BUDGET OFFICE

Mr. Chairman and Members of the Committee, I am pleased to appear before you to discuss the Congressional Budget Office's (CBO's) estimates of the receipts that might be generated by two proposals associated with television broadcasting technologies. For simplicity, I will refer to those proposals as Option I, technically known as the "analog return proposal," and Option II, sometimes called the "second-channel auction." My testimony today makes three points.

- o First, the radio spectrum is a valuable public resource. Auctioning licenses permitting use of the spectrum ensures that those licenses are granted to the parties who value them most and makes a substantial contribution to federal receipts. The Congress may choose among many different options in trying to capture those receipts to reduce the deficit. Prominent among the options are two proposals that direct the Federal Communications Commission (FCC) to pursue different strategies in moving the nation to a new television broadcasting technology.
- o Second, we stand at a fork in the road to the television of the future. The proposals discussed here today will lead to different allocations of a valuable part of the radio spectrum. The most important factors in choosing a course for the future are that the ultimate allocation of the spectrum produce the most value for society and that the benefits

of transition be equitably shared among broadcasters, viewers, and taxpayers.

- o Third, although federal receipts are an important factor in choosing a strategy for transition, the uncertainties involved in estimating spectrum receipts make CBO's estimates for the two proposals so close as to be indistinguishable.

THE SPECTRUM RESOURCE AND THE BUDGET

The radio "spectrum" does not exist as a physical object; rather, it is a conceptual tool used to organize and map a set of physical phenomena. Electric and magnetic fields produce waves that move through space at different frequencies, and the set of all possible frequencies is called the electromagnetic spectrum. The subset of frequencies from 3,000 cycles per second to 300 billion cycles per second—or 3 kilohertz (KHz) to 300 gigahertz (GHz)—is known as the radio spectrum.

Given the technology available, the supply of usable radio spectrum is limited: two parties attempting to use the same frequencies simultaneously and in sufficient proximity will find their signals interfering with each other. The supply cannot, however, be used up: turning an interfering signal off restores the spectrum's original

capacity. Moreover, improvements in technology effectively increase the supply by allowing higher frequencies within the radio spectrum to be used and lower frequencies to be used more intensively. Digital technologies now being widely adopted will dramatically increase the capacity of the spectrum to carry information--so much so that wireless communications may be on the verge of a new epoch.

The demand for telecommunications services drives the demand for the radio spectrum. The right to use a part of the spectrum is an indispensable ingredient in producing such private goods as cellular telephone service and television broadcasting and such public goods as communications for law enforcement and national defense. Digital technology increases the supply of usable spectrum, but it also opens the prospect of new services and increases the demand for the radio spectrum. The balance ultimately struck between the supply-side and demand-side ramifications of digital technology will be a major factor in determining the future course of spectrum prices and FCC auction receipts.

The Omnibus Budget Reconciliation Act of 1993 was a point of departure from the past both in the way the government manages the spectrum and in the relationship between the spectrum resource and the budget. For the first time, the market--in the form of auctions--replaced administrative proceedings and lotteries as the means of assigning the initial rights to use the radio spectrum. Those auctions have been widely heralded as a success. From a budgetary perspective, the radio

spectrum, sometimes referred to as the "invisible resource," became anything but invisible as the receipts from the FCC's first eight auctions began to mount. Winning bids from those sales will total \$18 billion (near-term receipts will be less since some auction winners will have up to 10 years to pay off their bids). The press reports predictions of even larger numbers in the future, particularly for digital television. It is not surprising then that both the Congress and the Administration have looked to the FCC auctions--and not exclusively prospects involving television--in efforts to balance the budget.

The recent Balanced Budget Act included provisions that both CBO and the Office of Management and Budget (OMB) estimated would generate \$15.3 billion over seven years. One provision--estimated to produce \$6.5 billion in receipts over seven years--extended the FCC's auction authority beyond 1998 and permitted the commission to auction more different types of licenses. A second provision directed the FCC to relocate lower-value users from a commercially attractive area of the spectrum and bring 100 megahertz (MHz) of spectrum to auction. A third provision directed the National Telecommunications and Information Administration--the federal agency managing the government's use of the spectrum--to transfer an additional 20 MHz of commercially attractive spectrum from federal to nonfederal use and ordered the FCC to auction that spectrum. CBO estimated that the second and third provisions together would produce \$8.8 billion in receipts.

In December 1995, H.R. 2530, popularly called the coalition budget, proposed adding the Administration's television transition plan—Option I, the proposal for analog return—to the spectrum auction provisions of the Balanced Budget Act passed by the Congress. I will discuss that proposal at some length in a moment. However, in the context of the budget packages considered by the Congress and the Administration thus far, the point is that OMB estimated the proposal would produce receipts of \$13 billion, whereas CBO estimated \$6 billion. In the heat of budget negotiations, a \$7 billion difference is large. Yet in the uncertain world of auction receipts seven years in the future, one should view CBO's and OMB's estimates as being close together rather than far apart. (CBO's new estimating assumptions close that gap by over half, but OMB has since increased its implicit estimate by almost a comparable amount.)

Although the law requires that CBO provide point estimates of the potential receipts from any proposal affecting the FCC auctions and that we keep our baseline estimates constant during the budget cycle, the uncertainty of the receipts is significant. Receipts depend on many factors, some of which are subject to change. Those factors include assessments by investors of future market conditions, rapidly changing technologies, the progress of deregulation in the larger telecommunications industry, and the FCC's future decisions about what pieces of the spectrum to make available for which uses under what conditions.

To date, receipts have been higher than CBO estimated. For example, our 1993 estimate of five-year receipts to the Treasury generated by FCC auctions was \$7.2 billion. Our December 1995 baseline estimate of receipts for that 1994-1998 period was \$11.7 billion. When we update our figures again to reflect the most recent auctions, we will increase that number even more. The estimates that are provided today for the alternative approaches to the transition to digital television are no more certain than those offered in the past. They are heavily influenced by private evaluations of such factors as technical advances, market conditions, the regulatory environment, and general economic conditions. Thus, in choosing between proposals, the Congress should not attach great significance to the small differences between the receipts that different proposals might generate.

The remainder of my testimony will provide some background on the impending changes in the television industry, describe two proposals related to those changes, present CBO's most recent estimates of the receipts that each proposal might generate, and briefly explore some other considerations related to the proposals.

THE TRANSITION TO DIGITAL TELEVISION

Today, slightly more than 400 megahertz of the radio spectrum is allocated to television broadcasting in several frequency blocks between 54 MHz and 806 MHz.

Adopting digital technology will decrease problems of interference and allow the frequencies allocated to television broadcasting to be used twice as intensively, in effect creating twice as many 6 MHz slots (the amount of spectrum now granted to a single analog television channel) in each television market.

Digital or advanced television was at one time synonymous with a dramatically improved picture and higher-quality sound—so-called high-definition television (HDTV). Digital technology would permit a broadcaster to offer two HDTV-quality film programs or a single sports program with a 6 MHz slot. Broadcasters, however, may wish to explore other options opened by the new technology, including using the information transmitting capacity of the 6 MHz slot to offer four to six programs of current quality. To watch digital television, however, viewers will need to replace their current TV sets or acquire set-top boxes similar to those now used by direct broadcast satellite subscribers.

The FCC began considering the issue of advanced television in 1987. The commission now proposes to provide each holder of a current broadcast license with an additional 6 MHz slot. The FCC does not have the authority to auction broadcast licenses. Thus, the "second channels" would be given to incumbents without charge. During a transition period of 15 years or longer, broadcasters would have the use of both their old analog slot and a new digital slot, allowing them to transmit both an analog and a digital signal and thus giving viewers time to adopt the new technology.

The recently enacted Telecommunications Act of 1996 requires broadcasters who choose to use a part of their digital spectrum to provide services other than advertiser-supported television—for example, local paging—to pay a fee based on the price paid at auction by other licensees to provide similar services.

At the end of the transition period, broadcasters would stop transmitting the analog signal and would return that spectrum to the FCC to allocate for other uses—such as additional cellular telephone service. Ultimately, the new digital channels could be accommodated within about 60 percent of the spectrum that is now allocated to television broadcasting and would be arranged within that spectrum (repacked) to free up large contiguous blocks of spectrum for those other uses. According to preliminary analysis, between 130 MHz and 150 MHz of spectrum would be available for auction after the 15-year transition period. CBO has not provided an estimate of the receipts that auctioning those frequencies might generate in the distant future.

PROPOSALS

Two prominent proposals would either modify or significantly change the FCC's long-standing proposal. Option I, the analog return proposal, would accelerate the FCC's plan to auction the returned analog spectrum but would not auction licenses permitting digital television broadcasting. Option II, the second-channel auction,

would auction the new digital television slots but would not free up spectrum for nonbroadcast uses.

H.R. 2530 included Option I, as proposed by the Administration. Option I would put into law major elements of the FCC's proposal. The key difference between Option I and the FCC's current proposal is that the transition period would not extend beyond 2005. Moreover, the rights to use the new spectrum would be sold in 2002—three years before the winning bidders could use the spectrum.

Option II, the proposal to auction the second channel, has not been presented in legislative form but has been articulated in general terms before the Congress and the FCC and widely discussed in the press. That proposal would create a number of new digital slots equal to the number of analog channels.

As early as 1997, the new digital slots would be auctioned to the highest bidders. The winners would be required to offer a minimum amount of advertiser-supported broadcast service. But they would be otherwise free to put any excess capacity to whatever use was most profitable and did not interfere with the rights of other license holders. Analog broadcast licensees could continue to broadcast indefinitely and would be permitted to buy a digital slot without selling their analog channel. To that end, legislation would have to specify relief from current limits on

station ownership. Current licensees could also convert their analog license to a digital license after a period of time and notification to their service area.

ESTIMATED AUCTION RECEIPTS FOR OPTION I

CBO estimates that, as part of a package similar to H.R. 2530, auctioning the analog spectrum as Option I proposes could add about \$11 billion to auction receipts in 2002. The estimate is higher than the \$6 billion estimate made in December for the same proposal because new data from the FCC auctions point in that direction.

In general, CBO's estimates of the receipts from future spectrum auctions assume that large blocks of contiguous spectrum under 3 GHz are a valuable commodity. For example, 60 MHz of spectrum allocated for personal communication services (PCS)—a new generation of cellular telephone service—offered in two 30 MHz blocks generated more than \$7.5 billion in receipts in the recently concluded "A" and "B" block auction. CBO assumes, however, that the value of such spectrum will fall from the levels paid in the auctions as more spectrum is brought to market. That assumption is based on trends in technology, policy, and regulation and their effect on increasing the supply of spectrum available to telecommunications markets. Specifically, those trends are:

- o That improved telecommunications technologies will allow more intensive use of parts of the spectrum already in wide commercial use and permit higher frequencies to be put to profitable use;
- o That under current policy, the FCC will follow the PCS allocation of spectrum for new wireless services with additional allotments of desirable frequencies for commercial uses, including those frequencies designated for transfer from federal to nonfederal use as directed by the Omnibus Budget Reconciliation Act of 1993; and finally,
- o That the FCC has demonstrated over the past several years that it will relax regulatory barriers impeding current holders of FCC licenses from expanding service definitions and applying their spectrum to new markets and services.

Taken together, those three trends will increase the supply of spectrum for nonbroadcast wireless services and intensify competition in telecommunications service markets. Competition will decrease service prices, profits, and eventually the prices that bidders are willing to pay for spectrum.

Consistent with that outlook, CBO's estimating approach takes into account the total amount of spectrum to be auctioned in a legislative proposal. To illustrate,

if the 150 MHz of analog return spectrum were the only frequencies to be reallocated and directed for auction in a legislative package, CBO would estimate more than \$15 billion in offsetting receipts. The legislative proposals that CBO has reviewed, however, also include 120 MHz of spectrum comparable to the analog return spectrum (large blocks of frequencies under 3 GHz). With 270 MHz to be sold at auction rather than 150, CBO estimates that the market-clearing price would be lower and that the analog return spectrum made available by Option I would add \$11 billion to total auction receipts.

The general approach that CBO has taken to estimating FCC auction receipts does not preclude accounting for other factors in evaluating a specific proposal. In the case of Option I, those factors include uncertainty about the amount of spectrum that will ultimately be made available and about the time when winning bidders would actually be able to use that spectrum.

CBO's working assumption has been that the analog return spectrum would total 130 MHz to 150 MHz. The most recent information, however, points toward the lower end of that range. Concerning timing, Option I requires that the returned spectrum be available for use in 2005. In that option, provision is made to subsidize the purchase of converter boxes by households that have not bought a digital receiver by that time. If the percentage of households unable to receive the digital signal in 2002 is large, however, it is reasonable to expect that the 2005 deadline might be

extended or that bidders would be cautious for fear that the deadline would be extended some time in 2003 or 2004.

ESTIMATED AUCTION RECEIPTS FOR OPTION II

CBO has estimated that auctioning all of the new digital slots in 1997 as Option II proposes, including those that would be provided to public television licensees under the current FCC proposal, would increase receipts by a total of \$12.5 billion in 1997 and 1998. That estimate would fall to \$9.4 billion if digital slots for public broadcasting licensees were set aside. CBO's estimate is based on a financial model of the digital broadcasting industry and a review of other estimates of the value of digital channels.

A key assumption of CBO's financial model is that the new digital channels would represent the first opportunity to enter local digital television broadcasting. The model provides estimates of the present value of a stream of profits for the digital channels, based on the assumption that licensees use them primarily to provide four streams of advertiser-supported TV programming, plus some software and data broadcasting, pay-per-view events, and advertising enhancements, such as additional product information that can be delivered to a viewer's home computer.

Other analysts have used different methods to try to estimate potential receipts from a second-channel auction. The commonly heard figure of \$70 billion, for example, is the upper end of a range from \$11 billion to \$70 billion that the FCC calculated by extrapolating the per-person, per-MHz prices received in the first four spectrum auctions. No connection exists between the markets for PCS and paging services and the television market, however, and hence the winning second-channel bids should not be expected to bear any particular relationship to those observed in previous auctions.

The FCC has also analyzed data on sale prices, advertising revenues, and depreciation costs of current TV stations and obtained second-channel estimates in the narrower range of \$23 billion to \$38 billion. Those data, though more germane than the PCS auction prices, are still difficult to relate to the value of the digital channels. Such channels may ultimately be more profitable than today's analog channels, but they will not be viewable until consumers acquire digital TV sets or set-top boxes.

The recent auction of a slot for direct broadcast satellite (DBS) service provides another relevant comparison point for a second-channel auction, one that yields dramatically lower estimates of potential receipts. Because the capacity of the DBS slot is equivalent to 40 6-MHz terrestrial channels--roughly three times the number proposed for terrestrial digital TV--MCI's winning bid of \$682.5 million

suggests that receipts from a second-channel auction might be on the order of a few hundred million dollars. Several factors could make the second-channel licenses more valuable to bidders than the DBS slot was, particularly the desires of viewers for local programming and the interest of advertisers in reaching local audiences. But the DBS result is certainly grounds for caution in estimating receipts from a second-channel auction in the tens of billions of dollars.

In summary, although CBO recognizes the large uncertainties surrounding any estimate of the potential receipts from Option II, we believe that our current estimate of \$12.5 billion is within the appropriate range provided by evidence from related services. In particular, we do not now find any persuasive arguments to support estimates significantly higher than ours.

OTHER CONSIDERATIONS

CBO's estimates of auction receipts from the leading proposals--\$11 billion for Option I and \$12.5 billion for Option II--are so close as to be essentially indistinguishable, given the uncertainties involved. Accordingly, if the Congress wishes to choose between the two proposals, it may want to make the choice on other grounds, such as their total contribution to the nation's economy. Both proposals have their advantages and disadvantages in that regard.

Even if the auction receipts could be predicted with perfect certainty, they would not settle the question of which proposal would be more economically valuable because each one auctions only part of the current TV spectrum. Option I would auction licenses to use the returned analog spectrum but not those for digital TV broadcasting; Option II would auction the digital TV licenses but not the existing analog TV licenses. From the point of view of the economy as a whole, the combined value of the services provided by holders of both the auctioned and unauctioned licenses is the appropriate measure. If the economic value of a given proposal is thought of as a pie, the estimate of the proposal's auction receipts corresponds to the size of some wedge of the pie but does not bear any direct relation to the size of the pie as a whole.

One reason to think that Option I might yield a larger economic pie is that it allows the FCC to reclaim the channels occupied by today's TV stations and repack the digital channels, thus creating sizable blocks of nationwide clear spectrum for new uses. All things being equal, large blocks of spectrum should be at least as valuable to the economy as small blocks because they allow a larger set of potential uses.

Conversely, one reason to think that Option I might be less economically efficient is that, in order to reclaim the analog channels, it forces all broadcasters to make the transition to digital at roughly the same pace, regardless of the circumstances of local markets. Some of the investments that broadcasters are

required to make under this plan may be uneconomical, particularly in smaller markets. Similarly, the plan forces viewers to choose between adapting and losing service on each analog TV set by a nationally determined date. Some households might otherwise prefer to replace or adapt some of their sets for digital TV, while continuing to receive analog signals on other sets until those wear out.

In contrast, Option II allows choices in a decentralized market to determine the pace of the transition from analog to digital television. That approach avoids possible inefficiencies of the centralized FCC plan but does not reclaim the analog channels, thereby forgoing the opportunity to create the valuable blocks of nationwide clear spectrum. The relative size of those two effects is unknown at present.

Other factors also distinguish the two proposals. For example, Option I may be more hospitable to developing high-definition television. The knowledge that analog TV sets will have to be replaced or adapted by a certain date might give a critical mass of consumers the incentive to upgrade to high-definition TV sets. Another distinction is that Option II can be easily modified to reduce the number of channels auctioned, since it does not have to provide every current broadcaster with an additional 6 MHz. Auctioning a smaller number of channels could reduce various problems involving congestion and loss of service to areas in large markets, cross-border coordination with Canada and Mexico, and displacement of existing low-

power television stations. At the same time, it could lower auction receipts and the benefits to digital TV viewers.

CONCLUSION

CBO's estimates of the Option I analog return and Option II second-channel auction proposals differ by a relatively small amount given the uncertainties involved. CBO estimates that either proposal would generate a substantial amount of auction receipts. The Congress's action on those matters will have important implications for the efficient use of the radio spectrum and the welfare of television broadcasters and viewers. Those implications deserve more attention than auction receipts, and they should play a larger role in Congressional decisions about the future of television broadcasting.

18

Chairman DOMENICI. We are going to have some questions, but we are going to go right through the panel, if you don't mind. Thank you.

Our next witness is Mr. Irving.

STATEMENT OF LARRY IRVING, ASSISTANT SECRETARY FOR COMMUNICATIONS AND INFORMATION, UNITED STATES DEPARTMENT OF COMMERCE

Mr. IRVING. Thank you, Mr. Chairman and members of the committee. I welcome this opportunity to testify on behalf of the Administration and present our proposal with regard to the auction of spectrum for broadcasting of digital programming.

The Administration proposal is very similar to the FCC proposal. Presently, every broadcaster in America has 6 megahertz of spectrum. We would loan every existing broadcast licensee an additional 6 megahertz of spectrum for simulcasting during a transition to a digital. We believe it very important that this Nation have a smooth transition to digital broadcasting.

We would, however, require existing licensees that use analog broadcasting to return the analog portion of the spectrum to the American people in the year 2005, and we would auction those channels in the year 2002. Again, this proposal is identical in every

respect to the FCC's proposal, except we would accelerate the transition, and we would then auction the spectrum.

Mr. Chairman, we recognize that there is no perfect plan before you today, but we believe the Administration's proposal is the most perfect plan. Senator Gramm talked about a middle ground, and this is exactly what we are trying to reach—that middle ground.

We think that this has a number of things that commend it. First, it preserves the broadcasters' ability, the United States broadcasters' ability to provide digital programming. We believe in the Administration that is very important. We understand the value that broadcasters provide to this Nation, and we recognize that a transition to digital will benefit both broadcasters and viewers alike. And we certainly look forward, as I noted in my written testimony, to a discussion this morning as to how we can accommodate the specific needs and particular needs of rural broadcasters or broadcasters in smaller markets.

We also think that our proposal benefits the telecommunications and information industries. Under our proposal, entrepreneurs would get 150 megahertz of contiguous spectrum nationwide at a time when our Nation still will be hungry for spectrum. We believe the taxpayers benefit. Taxpayers will get at least \$17 billion toward deficit reduction by the year 2002. And we believe that our Nation's economy would benefit. We would create thousands of jobs, billions of dollars of economic activity, created by moving the spectrum from broadcast use to other uses.

If we hold off for 15 years to give back the spectrum, there would be 5 years when the economy would not get that boost. If you look at what the cellular industry is providing, the cellular industry, since it began, has created 250,000 jobs across this Nation, including 60,000 jobs just with regard to the cellular industry itself, not including manufacturing and construction.

We have also seen——

Chairman DOMENICI. What is the economic boost that you refer to?

Mr. IRVING. The economic boost would be the new jobs, the new economic activity that would be created by putting 150 megahertz of spectrum out there to be used by the private sector to create new types of services, such as cellular services, paging services, and other services.

Chairman DOMENICI. All right.

Mr. IRVING. Wireless local loops, PCS, cellular, new technologies that we are not even aware of yet, would all be allowed to begin operation in the year 2005 instead of the year 2008, 2009, or beyond.

What we are trying to do is creating a win-win-win scenario. For a decade, broadcasters have known that the digital age is coming, and the Administration wants to ensure that every existing local broadcaster that wants to be a part of that revolution is a part of that revolution. But we also want taxpayers to get a return on their investment, on the property they own. The spectrum belongs to the American people. The spectrum can create \$17 billion, a minimum of \$17 billion worth of deficit reduction.

We also understand the concern about viewers, but we have talked to broadcasters, we have talked to the electronics industry.

It is not going to require that every viewer go out and buy an entire new television set to receive the benefits of the digital age. A viewer can go out and buy a \$20 to \$50 device as estimated by MSTV, which is a broadcaster trade association. For \$20 to \$50 in the year 2002, any American who wants to will buy a device, very much like the receiver for direct broadcast satellite. You will put it on top of your television. You will put a line between your antenna and the television. It will convert the digital signal to an analog signal. It is not going to require hundreds of dollars of investment by consumers. We are talking \$20 to \$50 per consumer per television.

What do consumers get for that? They get possibly six channels of free over-the-air broadcasting provided by the broadcasting industry. Or they will get a better quality signal, because even the television set you have in your home today is capable of rendering a better signal than it gives you. The reason the signal isn't very good is because NTSC, the existing standard, doesn't give you a great signal. But if you use a digital signal, even existing television sets with that converter box will be better and/or you will get six channels per broadcaster for a \$20 to \$50 investment per set. That is not an onerous burden on consumers.

But the reality is most consumers in America today have cable and/or will have cable television in the year 2005. The telephone industry is investing billions of dollars in creating multi-channel platforms. The cable industry is in 65 percent of households today. Most people are not dependent just on over-the-air broadcasting for television reception. And for those Americans who are or who will be, a \$20 to \$50 investment, maximum, as estimated by the broadcasting industry, will give them all the benefits of the digital age.

But, again, I want to go back to our economy. We disagree a little bit with CBO about the value of spectrum. We believe that spectrum will be more valuable, not less valuable, in the year 2005. No one knew this explosion would happen in cellular telephones. No one knew what PCS would envision. When you look at yesterday's newspapers, parents across the country are giving their teenage children cellular phones so that they can stay in touch at home when they go out on a date. A few years ago, we were doing that with pagers. That is wireless spectrum. We are making sure that people can have access to wireless spectrum. I am sorry, Senator?

Senator GRAMM. I was just envisioning as a child getting a call from Mom. [Laughter.]

Mr. IRVING. My Dad would have loved to have done that with my sisters. I can guarantee you. But we are seeing that millions of Americans do have access to cellular phones. We didn't foresee this explosion in cellular telephony. AT&T didn't foresee the explosion in cellular telephony. They sold off their cellular operations assuming the entire nationwide demand would be one million consumers. We are 30 million consumers and growing.

People carry around—right now I have in my bag a cellular phone. I have right here a little pager. And I carry a laptop anywhere I go in the country. To use that laptop, however, I have got to plug it into a phone line somewhere. I would like to be able to use that laptop with the same ease that I use my cell phone. Wireless technology would allow me to do that.

But if we don't have spectrum, we won't be able to have those kinds of efficiencies. Business men and women, people around this country, are benefiting from the efficiencies of having wireless technologies. We can do that 5 years earlier under the Administration's proposal. We can create thousands of jobs in a country where people want good jobs. We can create billions of dollars in economic activity. We can keep our leadership in telecommunications technologies by accelerating the giveback. We think that is fair.

Broadcasters can continue to broadcast in digital. We want that to happen. Viewers with a minor investment for some—because most households won't have to make any investment—will be able to be part of that revolution and will create new industries. That is what we think of as win-win-win. We hope that the committee will agree with us.

Chairman DOMENICI. Thank you very much.

[The prepared statement of Mr. Irving follows:]

PREPARED STATEMENT OF LARRY IRVING, ASSISTANT SECRETARY OF
COMMERCE FOR COMMUNICATIONS AND INFORMATION

Good morning, Mr. Chairman and members of the Committee. Thank you for the opportunity to testify today. The National Telecommunications and Information Administration, (NTIA), which is part of the Department of Commerce, is the principal adviser to the President on domestic and international telecommunications issues. I am pleased to be here today as the head of NTIA to present the views of the Administration on the matters before this Committee.

The focus of my testimony today will be the conversion from analog television to advanced television (ATV) and the preferable way of meeting the twin goals of ensuring that the American people receive the benefits of digital television as well as fair value for use of a scarce valuable national resource.

The transition to a digital television system is unlike anything previously attempted in American mass media. Because ATV is a digitally-based system that cannot be received by currently-used television receivers, simply turning off the analog signal and turning on the digital signal would disenfranchise the nation's millions of television viewers. In addition, an incomplete or partial transition could result in a fragmented television market operating in two different incompatible transmission standards. A successful transition will require acceptance of -- and investment in -- new technology by consumers, programmers, and broadcasters and other video

program distributors. If accomplished completely and quickly, the transition to digital television will provide unique and historic opportunities for the American people.

We believe that these goals can best be met by loaning existing broadcasters for the transition period the spectrum they need to upgrade to the new digital technology and then reclaiming the spectrum for licensing at auction. This proposal would permit a rapid and orderly transition to digital television while creating a minimum of uncertainty, confusion, and possibly wasted expenditures for consumers and broadcasters. It would also permit the FCC following the transition period to reorganize the television spectrum to optimize the amount and value of spectrum available for auction. While the Administration realizes that certain details of this proposal could undoubtedly be improved, we believe that, when measured against competing alternatives, it best balances sound public policies associated with a smooth transition to ATV with important budget objectives.

Before proceeding, I'd like to clarify one aspect of this discussion. Although returned spectrum is sometimes referred to as "analog" spectrum and the new ATV channels as "digital" spectrum, it should be noted that these are merely short-hand ways of referring to different methods of transmission over the electromagnetic spectrum rather than different types of spectrum.

I. Why Advanced Television is Important

Advanced television represents the next stage of development for America's free broadcast television system. Despite the proliferation over the past several decades of different methods of video programming distribution, broadcast television remains the primary means of disseminating and receiving information and entertainment in the nation. Unlike cable television and other subscription media, broadcast television is available to virtually the entire U.S. population, has no monthly fee, and requires no special equipment beyond a standard television set.

In addition, only broadcast licensees are subject to Federal Communication Commission (FCC) public interest requirements to serve the interests and needs of their community through locally-oriented news and programming. This system of free locally-based broadcast television has worked well for half a century and is widely regarded as the most successful broadcast system in the world. The localism, universal service, and diversity of this system should be maintained as television advances into the next generation.

The shift to digital television is particularly important because the technical constraints imposed by the existing analog transmission standard have until now made it impossible to upgrade television to permit use of more sophisticated technology. Even when the United States adopted a color television process in the 1950s, we perpetuated the spectrally

inefficient features of the NTSC system to avoid making existing black and white receivers obsolete. Broadcasters have long advocated the importance of converting from analog to digital television. Now we have the opportunity not only for dramatic television improvements but also to make the nation's broadcast television system more spectrum-efficient and to free up substantial amounts of spectrum to auction for new uses.

Digital technology can dramatically improve television and bring important benefits to millions of Americans in at least three areas -- better quality pictures and more viewing choices, advancement of American technological strength, and the more efficient use of the radio frequency spectrum. Advanced television could give viewers dramatic, new entertainment and educational experiences. And, if digital broadcasters choose to provide multiple channels using a digital signal, ATV would also provide 4 to 6 channels for every channel provided today. By using a digital medium, broadcasters will also have the flexibility to offer a variety of other "ancillary and supplementary" services to consumers.

ATV's technological benefits are already being seen in the medical and research fields. For example, telemedicine applications are now available that allow doctors to "examine" patients in remote locations. The flexibility and versatility of this new medium will undoubtedly stimulate myriad new applications in fields such as teaching, manufacturing, and science that cannot even be dreamed about today.

Finally, ATV technology uses radio frequency spectrum more efficiently than the current system. As a result of ATV technology, broadcast television's current requirement for 402 MHz of spectrum could be reduced significantly to 252 MHz, saving up to 150 MHz of prime spectrum for other uses. More importantly, although today's broadcasters must be reassigned to a new channel for that service, the channel it vacates may be even more valuable after the FCC has repacked the spectrum and allocated it for new uses.

II. The ATV Transition Process

In the mid-1980s, when the potential for advanced television first burst upon the American scene, it appeared as if America had already lost the race to develop the new technology. The development of digital broadcasting in 1990 by U.S. companies and researchers, however, propelled America to the lead. After many years of hard work through the FCC's Advisory Committee on Advanced Television Service, four competing companies reached a pact to combine their systems, resulting in the formation of the HDTV Grand Alliance in 1993. The Grand Alliance proposed a transmission standard that sought to accommodate the competing needs of the television, cable, and computer industries.

For nearly a decade, the FCC has been wrestling with the question of how best to convert the nation's television system from the current NTSC format to this next generation of technology without disenfranchising the nation's television

viewers. With the development of a workable digital system by the Grand Alliance, the debate has narrowed over the past several years as attention has focused on a few specific transition alternatives.

Under the scenario outlined by the Commission in several 1992 releases, each existing broadcast licensee would be loaned additional spectrum in the form of a new paired ATV "transition" channel, which would be used in part for simulcasting during the conversion to digital television. After a period of 15 years, broadcasters would be required to cease analog broadcasting and to return the analog channel to the government for reallocation to other uses. It should be noted that this plan represents only a tentative proposal by the FCC, and the Commission has not yet made a formal decision on the best way to proceed. Continuing technological advances suggest the transition will be more rapid than previously expected.

A second proposal, which is supported by the Administration, adheres to many of the FCC's tentative conclusions but provides for a more rapid transition to digital and requires the licensing of the returned "analog" spectrum through auctions. Existing licensees would be loaned a second channel for a transition period and would be required to cease analog broadcasting and return their original channel to the government no later than 2005. The FCC would reorganize or "repack" the spectrum to maximize both the amount and desirability of spectrum available

to be auctioned for other services. Returned spectrum would then be licensed at auction for other uses.

Under a third proposal, the new ATV channels would not be assigned to existing broadcasters but would instead be licensed at auction to the highest bidders. This proposal would allow entities other than current television licensees to compete in the broadcasting business and would allow auctions for the new spectrum to be held relatively quickly. Under this plan, analog and digital licensees would both broadcast in different transmission standards for an indefinite period, since analog licensees would continue broadcasting in NTSC format (although they could potentially switch to digital at a future, though indeterminate, date).

III. "Analog" Auctions Balance Sound Public Policy and Budget Objectives

Because of the importance of the Nation's broadcast television system, it is essential to devise a transition mechanism that is least disruptive to viewers and ensures that both broadcasters and viewers are able to make the transition from analog to digital television. Loaning existing broadcast licensees for a limited time the spectrum needed to make possible a transition to digital television -- and licensing the returned spectrum at auction following conversion -- is the best means for achieving this conversion for several important reasons. We believe this approach would benefit the viewing public and broadcasters as well as meet the Government's budget objectives.

A. "Analog" Auctions Would Ensure a Orderly Transition for the Nation's Television Viewers and Broadcasters

The plan to auction returned "analog" spectrum would, as did the FCC plan on which it is based, allow a transition to digital television that would protect the nation's television viewers. Under the plan, they would be able to continue to use their current televisions since broadcasters would be required to broadcast in both analog and digital formats during the transition period. Thus, an orderly transition to digital television as envisioned in the FCC's proposal would be ensured.

While some have claimed that under this proposal broadcasters would receive a windfall in the form of free access to a valuable resource, in fact, broadcasters would be loaned an additional channel for a finite period to ensure a smooth transition to digital television. On a date certain, broadcasters would be required to cease analog broadcasting (and return the analog channel), thereby ensuring that digital television becomes the national television standard.

Loaning transition spectrum to existing broadcast licensees would also make full use of the broadcasters' base of knowledge, experience, and investment in this highly specialized and complex business. Whereas a new entrant into the market might be required to build facilities from scratch, existing licensees would need only to upgrade existing facilities, thus expediting the conversion to digital.

On the other hand, "digital" auctions may result in a less orderly and complete transition to digital broadcasting. If we

do not develop procedures now to provide incentives for today's broadcasters to migrate to new channels for digital operations, we may find ourselves with a fragmented television system for an extended period of time.

B. Licensing the Returned Spectrum at Auction Would Allow the American Taxpayer to Recover the Full Value of the Spectrum

The accelerated time frame for transition would also help achieve the important goal of achieving a balanced budget by 2002 and allow the American taxpayer to recover the full value of this prime spectrum. The Administration estimates that an auction of the returned spectrum would yield at least \$17 billion for the U.S. Treasury. This estimate is based on the FCC's range of \$20 to \$132 billion in revenues from auctioning the "analog" spectrum. Since the auctions of returned spectrum will actually take place in 2002, the most conservative FCC estimate was reduced to allow for the three-year delay in companies' actually being able to deploy services. Based on the phenomenal success of the FCC auctions to date, the Administration is confident that \$17 billion will be the minimum that will be raised through auctioning the "analog" spectrum. To ensure that this minimal value is received from auctions, however, the Administration has developed a contingency mechanism that would permit assessment of a fee on recipients of ATV licenses in the event of a shortfall in auction receipts.

1. The Need for spectrum will Continue to Grow

While some entities have opined that the demand for spectrum will not be as strong when the "analog" spectrum is returned by the ATV licensees, most experts in the telecommunications field believe that demand for spectrum will continue to soar in the coming years as wireless services become more ubiquitous. Experts anticipate that spectrum-hungry wireless applications will continue to multiply at a rapid pace, including land mobile applications, PCS, wireless data systems, telemedicine and biomedical services, and wireless portions of the local telephone loop. All of this is happening much faster than most people anticipated. A 1983 study commissioned by AT&T forecast a total of less than one million cellular users by the year 2000. There are presently over 30 million cellular users in the U.S., and the number is expected to double by 2000. Considering that the cellular industry has created over 250,000 jobs using just 50 MHz of spectrum, the Administration's proposal, which would free up 150 MHz of spectrum, would likely create even more jobs.

Even if these predictions somehow prove to be incorrect and the overall demand for spectrum is not as high as we anticipate over the next decade, the returned television frequencies will be in prime parts of the spectrum with characteristics that make them excellent for land mobile and other uses. Given the ever-growing demand for spectrum -- such as that located in the 40 GHz to 200 GHz range -- that until recently was virtually unusable, the demand for spectrum in the prime frequencies of the

television bands (54 MHz-806 MHz) will undoubtedly continue to be strong.

2. **Licensing the Returned Spectrum Would Facilitate Repacking the Spectrum Into Contiguous Blocks and Would Maximize Its Value**

One of the major benefits of auctioning the returned "analog" spectrum rather than the "digital" spectrum is that the former proposal will permit the FCC more readily to "repack" the spectrum after transition, maximizing both the amount of spectrum available for auctioning and the value of the frequencies made available.

Under the "analog" auction scenario, the FCC will have the ability to "repack" the broadcast spectrum without regard to the more demanding interference characteristics required by analog broadcasting. Repacking will permit the FCC to locate digital broadcasting so as to permit the most logical and efficient use of the spectrum for modern technologies. As discussed above, this would not be possible if the initial "digital" spectrum were auctioned off and analog licensees continued broadcasting indefinitely, interspersed among the digital channels.

Repacking would have several benefits. First, repacking would maximize the amount of spectrum available for auction. The amount of spectrum that would have to remain fallow in each market to prevent interference would be determined by the minimal digital separation requirements rather than those for analog television. The FCC estimates that as much as 150 MHz of prime spectrum would be available in each market for auction following

repacking, while less would be available to auction in most markets in the "digital" auction scenario.

Second, the ability to repack the channels efficiently would result in nationwide contiguous spectrum blocks that could be divided into smaller nationwide bands devoted to specific services such as two-way applications, point-to-multipoint distribution services, as well as mobile services. Systems that are designed to operate nationwide will in many cases be cheaper to manufacture and operate, since the transmitter and receiver equipment will not require built-in flexibility to accommodate different operational characteristics.

Moreover, because under a "digital" auction scenario, analog and digital broadcasters would share the television spectrum, all frequency assignments would remain subject to the inefficiencies of the NTSC broadcast television system, which requires many channels to be left vacant in each community to avoid interference. The "digital" auction proposal could potentially double the amount of spectrum used for broadcasting, leaving a much smaller amount of spectrum available for auction for other uses. Auctions of digital channels would thus result in a less efficient use of this highly valuable spectrum.

C. The Costs to Broadcasters and Consumers of a Rapid Transition are Reasonable

1. The Costs to Consumers

Because under the Administration's proposal analog broadcasting will cease in 2005, consumers would have to have the

ability to receive digital television signals by then. We anticipate that the vast majority of American households will have either a digital television set or some other way to convert digital signals to analog signals. For example, by 2005, it is expected that most cable television systems will either have switched to digital signal transmission and provided their subscribers with converter boxes to receive these signals or will be able to convert digital signals to analog signals at the cable facility. Currently 60-65 percent of television households subscribe to cable. Thus, millions of consumers will be able to receive digital signals without buying a set top converter box or a new television.

Estimates on the total number of consumers who because they do not subscribe to a multichannel service will need to buy a television or a set top box to receive digital signals range from 10 to 20 percent. By 2005, some smaller percentage of consumers still will not have purchased a digital television or a converter. (It is worth noting, however, that because broadcast programming will continue to be a significant portion of the programming carried by multichannel video providers, consumers will continue to spend a significant amount of time watching broadcast channels, even when the vast majority of television households subscribe to a multichannel provider.)

The Association for Maximum Service Television estimates that by 2002 converter prices will be down to \$20 to \$50 per unit. The Administration is considering a plan to help alleviate

the burden that purchasing converters will impose on some consumers and debating whether, to alleviate the cost to consumers, it would be appropriate to rebate to consumers 50 percent of the cost of the converter box, up to \$25. At \$25 per television household, the cost to broadcasters of assisting consumers that do not have the capability to receive digital signals would be \$25 million if one percent of television households qualify for a converter box rebate and up to \$250 million if ten percent of television households qualify. It is important to note that, in return for the cost of buying the converter boxes, consumers will be compensated by the ability to receive as many as six times the current number of channels.

2. The Cost to Broadcasters

The cost to convert each analog broadcaster to digital broadcasting vary dramatically, based on geography and station operations. The 1992 Advisory Committee on Advanced Television Service (ACATS) estimated the cost of conversion to digital for broadcast stations as low as \$1.3 to \$1.6 million per station, while the NAB's current estimate ranges from \$1.5 to 10 million per station. With a date certain of 2005 for spectrum reversion, broadcasters would still have a significant amount of advance notice that equipment had to be replaced. Since the expense of buying new equipment would be spread over time, much of these expenditures would be incurred through normal studio and equipment upgrades. Many stations, especially those owned by networks and large group owners, have already begun to incur

these costs as part of their routine upgrades and replacement schedules. A more rapid transition could require broadcasters to purchase equipment before the prices have significantly fallen. On the other hand, market forces may result in prices falling sooner than is now anticipated. The Administration is committed to finding ways to ease the transition to digital television for the smallest broadcasters and would like to work with Congress to develop suitable proposals.

IV. Conclusion

In conclusion, Mr. Chairman and members of the Committee, I want to emphasize again how important it is that we ensure a smooth transition of our national broadcasting system from one based on analog transmission technology to one that uses digital technology, the best that this country has to offer. Free over-the-air television is vitally important to the nation and must be able to compete with other video providers, such as cable and satellite services. The Administration proposal would ease the transition to digital television by making each of today's broadcasters eligible for an ATV license. At the same time, it would also recapture for auctioning, on behalf of the American public, a full 150 MHz of radio spectrum. While there are alternative ways to achieve this second objective, we believe the Administration proposal is most consistent with sound telecommunications policy.

Mr. Chairman and members of this Committee, again, I appreciate this opportunity to share these views with you. I am ready to respond to any questions that you may have.

16

Chairman DOMENICI. Mr. Mike Burgess, General Manager, KOB-TV, Albuquerque.

STATEMENT OF MIKE BURGESS, GENERAL MANAGER, KOB-TV, ALBUQUERQUE, NM

Mr. BURGESS. Thank you, Mr. Chairman, for the opportunity to present testimony on behalf of the New Mexico television broadcasters on this important issue.

New Mexico, not unlike many television markets in the Western United States and the Central Plains, is made up of a highly diverse population, culturally, geographically, and economically. The Albuquerque television market is the second largest geographic market in the United States, covering over 100,000 square miles, which includes most of the State of New Mexico, as well as part of southern Colorado and eastern Arizona. We are at the southern end of the Rocky Mountains and have some of the most rugged and beautiful terrain in the country. But this means that the job of providing over-the-air television service is far more challenging, difficult, and expensive than providing the same service in many other areas.

New Mexico broadcasters have met the challenge of providing service to this vast area in two ways that are virtually foreign to more densely populated areas. First, there are nearly 400 television translators operating within our market to provide over-the-air television signals to communities who could not otherwise receive a usable signal. These translators are small, fairly low-powered television transmitters that receive the main signal, be it microwave or from high on a mountaintop, and retransmit it into an area that is unable to get the main signal. Most of these translators are owned by small non-profit community groups. Only about one-fourth are owned by television broadcasters.

The second method we use to cover this area are called satellite stations. A terrestrial satellite station is a full-power signal licensed to communities that are too small to financially support the expense of a full-service TV station. In order to provide service to the community, a larger station will build a satellite in a smaller community, which rebroadcasts the main signal. Now, in most cases, the satellite station will also provide local weather, news, and public service programming specific to the smaller community.

We have been talking and planning the difficult conversion to the new digital television system for several years now. Because of our unique delivery system, this conversion will be difficult, time-consuming and very, very expensive. It has been generally agreed that the full conversion of a typical television station to the new digital standard will cost \$8 to \$10 million. These numbers are based on the typical station that operates one studio and one transmitter facility.

New Mexico, like many other markets, is not typical. The entire delivery system that I have just described to you will require con-

version to digital. Not only must we build new studios and transmitter facilities in Albuquerque, but we must find a way to convert the eight satellite stations, as well as the nearly 400 translators that serve 150 communities.

While we do not yet know the cost of replacing the 400 translators, a reasonable estimate places that cost in the \$10 million area.

Now, remember that I said nearly three-fourths of these translators are owned and operated by community groups. Many of these groups rely on broadcasters to pay their electric bills, to do their maintenance, and even pay their \$45 license fee to the FCC.

Chairman DOMENICI. Mr. Burgess, what is a translator?

Mr. BURGESS. A translator is a small television transmitter that rebroadcasts the main signal. The Albuquerque signal gets out about 70 miles. After that, I have got to pick it up and relay it gain on to another transmitter and get another little coverage area. Because of all the mountains in New Mexico and all of the terrain, you can't get a clear shot all the time. And if we are going to serve the entire State, you need to have a series of translators.

Chairman DOMENICI. Thank you. Proceed.

Mr. BURGESS. Thank you.

The communities that depend on the translators simply do not have the resources to replace them. New Mexico broadcasters, however, recognize the importance of the transition to digital television and to the future of our business, and we will make this change.

The very future of free TV in New Mexico is hanging in the balance as Congress looks at the issue of spectrum options. The fact is we simply cannot afford to gain the new channels through competitive bidding and then still afford to construct the necessary facilities. The switch to digital transmission will provide no new advertising revenue and will provide no new viewers. In fact, it is likely that we will actually lose some viewers in the transition to digital because of displaced translators.

We are anticipating expenditures of perhaps as much as \$30 million per network station and their satellites just to provide new services.

Chairman DOMENICI. Mr. Burgess, could I interrupt with one more question?

Mr. BURGESS. Sure.

Chairman DOMENICI. You mentioned free TV versus cable in New Mexico. It has been stated in the record that nationally 65 percent of the American people are tied into cable. Just doing the arithmetic, that would mean 35 percent aren't.

In New Mexico, I understand that is not the situation. For a rural State like ours, what is the ratio?

Mr. BURGESS. In New Mexico, Mr. Chairman, the cable penetration is at 59 percent, which means 41 percent of the population, over 560,000 people, don't get cable or other pay services. They get all of their television from over the air.

If I might add just a quick one, a lot of the cable systems in New Mexico get their network television by picking it up off of our translators. They are not taking it off a satellite or anything else. There are a number of communities of that 59 percent that

wouldn't have broadcast television of local news without our translator system.

Chairman DOMENICI. Please proceed.

Mr. BURGESS. Thank you.

Again, to say if we are not able to make the conversion, 41 percent of the population, over 560,000 people in our market, who rely solely on free over-the-air television, either because pay services are not available or are not affordable, will eventually be without any broadcast television service. For many of these people, television is their only source for weather and news, and for economic reasons, it may be their main source of entertainment.

We cannot compete in bidding against the telecommunication giants for the necessary spectrum. Therefore, the new channels will certainly either become pay TV or be something used for something other than television service. We will become a second-class service and eventually fade away.

The alternative of an accelerated conversion and auction, as proposed by the Clinton administration budgeteers, will still present tremendous problems to New Mexico. While that plan would at least assure our conversion and continued operation, the effects on the consumer would be devastating. New Mexico could certainly not complete such a conversion within the time frame that we have heard discussed. The enormity of our system would make it physically impossible to convert within 7 years.

That means that thousands of our viewers would simply lose TV for some period of time. But, more importantly, an artificial time scale would put an enormous financial burden on that portion of the population who could afford it the least. A total conversion to digital will require the replacement of over one million television sets in New Mexico. While we don't know the exact cost of the new sets, they will be expensive. A conservative estimate of the initial cost is \$1,500 per set. The initial cost for a set-top converter has been given to us as \$500 and maybe eventually as low as \$150 to \$200. That means up to a \$1.5 billion tax for a State that ranks 46 in per capita income. Obviously a tremendous burden.

Many of the people who rely on free TV do so because they cannot afford pay services and certainly could not afford the cost of new sets or converters.

When we made the conversion from black and white television to color television, we let the market drive the conversion. Ten years after the start of color broadcasting, only 29 percent of the population had color sets. I can reasonably assure you that in 2005 the penetration of digital sets will still be very low.

Finally, there has been talk about auctioning the upper portion of the UHF spectrum for other services. Of the nearly 400 translators that serve our communities and our market, more than one-half of them operate in the UHF band. While not all of these would be displaced by the UHF auction, many would be, and there is simply no other available channels. An auction of the upper UHF spectrum would doom many of these communities to no television service of any kind. That auction would also destroy the proposed spectrum plan for existing broadcasters and leave us in limbo regarding a transition to digital.

In the end, we are certain that an auction of the spectrum necessary for digital broadcasting will be the end of free TV in New Mexico. The market revenue just does not exist to make it viable. The total cost of conversion to digital to New Mexico broadcasters will exceed the entire annual market revenue by 50 percent.

There is no way for us to financially bring the age of free digital television to New Mexico and bid for the spectrum. Free television will simply disappear.

Mr. Chairman, let the consumers drive the conversion to HDTV, high-definition television, and not the Government. Thank you very much.

Chairman DOMENICI. Thank you very much.

Now we have our next witness from the State of Nebraska, Howard Shrier, President-Elect of the Nebraska Broadcasters Association. Thank you so much for joining us.

STATEMENT OF HOWARD SHRIER, PRESIDENT-ELECT, NEBRASKA BROADCASTERS ASSOCIATION

Mr. SHRIER. Mr. Chairman, Senator Exon, and other members of the committee, thank you for the opportunity to appear at this hearing today. I bring warm greetings from the great State of Nebraska, home of the Huskers. They are, of course, the number one-ranked college football team in the country for the second year in a row. Go Big Red.

I am Howard Shrier, Executive Vice President and General Manager of KPTM Fox 42 and KXVO Channel 15, the Warner Brother-affiliated station in Omaha, Nebraska. In my 20-plus years in broadcast television, I see spectrum auctions as the single biggest threat to the future of free television as we know it today. Should spectrum auctions ever be the law of the land, most television stations in Nebraska would go dark, and that is the issue, because if auctions are required, local stations will not have the financial resources to compete for the auction. Make no mistake, if that happens, one day there will be no free over-the-air television.

My company, Pappas Telecasting, has a record of building stations from the bottom up in small and medium-sized markets. We are proud that we have created full-fledged, high-quality television services where before there was only static. We have built new stations in Fresno, Bakersfield, Reno, Ashville, and two in Omaha, with permits pending in Sioux City and Des Moines. The investment in each of these stations range between \$5 and \$15 million for just the initial process of development.

Our company has already begun to invest in digital technology based on the FCC's transition plan to high-definition television. You will recall the Commission was concerned about the impact on consumers so it proposed that current broadcasters be assigned the use of a temporary channel to allow consumers time to move to the new technology in an orderly fashion.

Today, after years of research and millions of dollars in development, we now stand on the brink of launching a new digital television system that is second to none and largely American owned. But to come to broadcasters now and deny us the fruits of our labor, deny consumers the reality of digital television, is just plain wrong.

In Nebraska and Iowa, there are rural areas served only by over-the-air broadcasters. Our service to these homes, rich and poor, has always been free and universal. It is only American broadcasters who can realistically bring the benefits of digital television to everyone, everywhere, and for free. We are ready and willing to begin the process now, but we have two concerns and the first is cost.

We cannot afford the \$8 to \$10 million to go to digital and at the same time be forced to bid at auction for spectrum we will need to make the transition. Requiring us to bid against the telecommunications giants of today, cable, phone companies, cellular, for spectrum simply is not logical or possible. We will end up being the eight-track tape technology of the 21st century—the eight-track tape technology of the 21st century.

That is not just me talking. Ulysses Carlini of KNOP in North Platte, Nebraska, says if he has to pay for spectrum, he'll eventually go off the air, ending all-local service to 14,000 homes. George Singleton of the Nebraska Television Network in Carney, Nebraska, says auctions would not be just devastating, they would be impossible. And John Benson of KHAS in Hastings, Nebraska, says if up-front auctions occur, local news and public service will be lost to 35 counties in central Nebraska. Let me assure you that each of these broadcasters understands that they must go to digital to survive in an increasingly competitive marketplace.

Our second concern is timing, any plan that accelerates the transition period creates another problem for broadcasters and consumers. Our engineering analysis indicates that 50 percent or more of the towers now used by television stations will not support a second antenna to deliver digital television. That means either strengthening current towers or building new ones, and with only a handful of companies still making and erecting towers, we are looking at a lengthy process to even get digital signals on the air.

So even if you wanted to accelerate the process and you began licensing stations next year, it will be 2002 before many stations will even be able to broadcast the first minute of digital programming. Moreover, no consumer is going to buy a digital set until there is digital programming to watch, further lengthening the time we need for an orderly transition to digital. By the year 2005, we will be lucky to have 1 or 2 percent penetration of digital televisions.

Please keep in mind another point. Even though we are undergoing a very expensive technological change, we will not automatically increase our audience or our advertising revenues. So why are we doing this? To stay competitive and to ensure the future of free over-the-air television.

The bottom line is that the impact of either up-front auctions or an accelerated give-back will be devastating, not only on my station but on the citizens of Nebraska and Iowa who someday will no longer have free television service. That means a loss of local news, weather, sports, public affairs, and much, much more.

Mr. Chairman, in Nebraska and Iowa, as in the rest of the country, we take our license to broadcast very seriously. We are proud of our record of service to television viewers. At KPTM Fox 42, our slogan is "We're your station" and our audience believes it. But if

we are faced with up-front auctions or an accelerated give-back, then we won't be anybody's station.

I urge you to let the FCC plan go forward as originally intended. Spectrum auction is not the solution to balancing the Federal budget. I thank you.

Chairman DOMENICI. Thank you very much.

[The prepared statement of Mr. Burgess and Mr. Shrier follows:]

PREPARED STATEMENT OF MIKE BURGESS, KOB-TV, ALBUQUERQUE, NM AND
HOWARD SHRIER, NEBRASKA BROADCASTERS ASSOCIATION

Thank you, Mr. Chairman, for the opportunity to present joint testimony by New Mexico and Nebraska television broadcasters on this important issue. The very future of free television in New Mexico, Nebraska, and the rest of the country is hanging in the balance as Congress looks at the issue of auctioning off the spectrum our stations need to make an orderly transition from the current analog service to the wonders of digital television.

We strongly believe that auctions will destroy the ability of our local stations to make this transition, a transition which is occurring in every other form of communications services. If auctions are allowed to occur, then we believe most stations, including those in Nebraska and New Mexico, simply will be unable to outbid larger media competitors — such as cable, regional phone giants, cellular interests and others — and thus the foundation of local, free broadcast television that we provide will be undermined.

Hearings in the House and Senate Commerce Committees will be held soon to look at the communications policy implications of auctions. We support those hearings and look forward to testifying at them.

But today, our focus will be limited to the scope of this Committee's jurisdiction — specifically, the economic impact that auctions would have on consumers and broadcasters in New Mexico and Nebraska, and to shed some light on why we believe the revenue estimates that have been suggested from auctions are farfetched. We also will look at the technical realities we face in making this transition from analog to digital, and show how those realities throw into serious question the amount of time which some advocates argue the transition will take.

The Transition to Digital

All forms of human communication — save for face-to-face meetings — are moving to digital technology. Digital technology is the same technology that drives American computers — converting information into data “bits” that can quickly move across the street or around the world. Digital technology has given American communications businesses a huge leg up on every other nation in the world, and that growth accounts for the fact that one-sixth of the U.S. economy now revolves around telecommunications.

Nearly ten years ago, during the Reagan administration, the FCC, Congress and the broadcasting industry began to look at new television technologies, particularly developments in Japan and elsewhere that promised televisions with breathtaking picture and sound quality. The FCC decided that certain principles would govern the development of a replacement for the NTSC system that had governed television broadcasting since the 1940's. It decided that no additional spectrum would be allocated to television and that consumers who had invested in the existing system should not suffer. Accordingly, the search began for a system that could work in the “buffer” channels between existing stations, spectrum that could not be used for traditional analog television service.

At that time, all of the experts believed — and so testified before Congress — that a digital television signal could not be transmitted within the six MHz bandwidth of a television channel. American engineers, however, proved these experts wrong and, began to develop what is now the Grand Alliance digital television system. The broadcasting and manufacturing industries have invested millions of dollars to develop this technology and the results have been

astounding. Truly, American television technology again leads the world and we think there is a good chance that the system we have developed will become the worldwide standard.

After years of careful planning, the FCC came up with a reasonable transition plan. The Commission was concerned about the impact of the conversion to digital on consumers. In addition, the Commission did not want to disrupt the availability of free over the air service. The FCC proposed that current broadcasters be assigned the use of a second channel on a temporary basis in order to allow them to offer both analog and digital services simultaneously. Then, as consumers move to the new technology, stations would return the analog spectrum to the government, and the entire country will have moved to digital technology. At the end of the day, TV broadcasters, who currently each have six MHz of spectrum, would end up with the same amount — six MHz. The FCC believed that the transition would take about 15 years once it assigned digital licenses.

More importantly, however, the overall amount of spectrum allocated to television service since 1945 will ultimately decline because the digital channels will only occupy part of the present TV spectrum and the rest can then be reallocated for other purposes. That can't happen now because, with analog services, those unused channels are needed as "buffers" to prevent interference. This is a rational plan that allows consumers and local broadcasters such as ourselves the time they need to make this change in technology workable.

Digital technology offers the promise of remarkably improved picture and sound quality, using channels no wider than today's analog signals require. Although some people now argue that broadcasters will not provide High Definition Television service as the FCC contemplated, the industry in fact plans to provide HDTV service. The Grand Alliance digital TV system also

permits broadcasters to provide at certain times enhancements to their signals, such as giving viewers a choice of camera angles at sporting events, or other services such as multiple television signals or data transmissions. The transition to digital technology will allow us to bring these benefits to television viewers in New Mexico and Nebraska

Digital conversions are already underway in the cable industry. Satellite services provide digital signals already. And any video services provided by the telephone companies also will leap to digital technology. Unlike local broadcasting, however, none of these competing services is free to consumers. If local broadcasting is going to keep its audience, and thus continue to provide quality service to all Americans, it must remain competitive with these other technologies. And that requires television stations to become digital. Otherwise, over-the-air free television will soon be viewed like the buggy whip did once automobiles came on the market.

Spectrum auctions will throw a major roadblock into local stations' ability to convert to digital technology. Any changes in the FCC plan caused by auctions will mean delays in implementing advanced television, further inconvenience to consumers, a loss of potential American jobs in the manufacturing of receivers, and will leave American consumers with, at best, an inferior broadcast service.

Auctions Will Kill Free Television

In order for us to make the transition, we will need to spend millions of dollars for new transmitting and production equipment. We estimate that a typical station providing local news will need to spend between \$8 and \$10 million to convert to digital. That includes a new transmitter to provide the digital signal, along with new switching equipment, new cameras, new

editing equipment, and so forth. Basically, each of our stations will need to replicate most of the equipment it now owns in order to put the second, digital channel on the air.

These costs alone will already be a daunting hurdle for many stations. Indeed, for some stations, particularly those in smaller markets, the cost to convert to digital could exceed the net worth of the station itself. In New Mexico, for example, the cost to change to digital exceeds the entire annual revenue of the television advertising market by 50 percent. Securing the financing for this new equipment will be difficult.

But now — at the 11th hour — to require stations to bid for the channels they need to make the transition puts the entire process at risk. Broadcasters will realize no new revenue from going digital. They will merely be slowly moving their current audience from one technology to another. And since advertising prices are based on ratings, not on broadcasters' costs of doing business, there is no reason to expect stations to be able to pass on auction costs to their advertisers.

Let's not forget that of the nation's television households, fully 34 percent have no cable access at all. And of the nation's television receivers, only 55 percent are hooked to cable or another multi-channel provider. In Nebraska's three major markets — Omaha, North Platte and Lincoln — cable penetration averages 65%. In Albuquerque, cable penetration is only 59%. Locally, that means that hundreds of thousands of citizens rely on local broadcasting as their only source of television. Nationally, that number grows to tens of millions. If auctioning the transition channels means that many local broadcasters simply cannot convert to digital service, and the channels now reserved for local digital television broadcasting are used for pay TV or other purposes, citizens of Roswell, New Mexico or Ogallala, Nebraska and millions more across

the country will lose much or all of the television service they now receive as local broadcasting becomes technologically obsolete and unable to compete.

Upfront Auctions Will Cause Other Problems for Broadcasters and Consumers

If digital TV spectrum is auctioned upfront, consumers and broadcasters will face a myriad of other problems. For example, the Grand Alliance digital TV system was carefully engineered to operate within the gaps between analog TV signals without interfering with existing service. Virtually no other type of service — analog or digital — could be placed in those channels without causing interference, unless the other service were limited in both power and spectrum bandwidth. But if these channels instead are auctioned to the highest bidder, there is nothing compelling the purchaser to use them for advanced television. And non-broadcast uses of that spectrum would cause interference to the existing analog service, or the conditions placed on the use of those channels would result in inefficient use of the spectrum and the waste of a valuable asset.

Another loser would be the American job market. Two of the major television manufacturers with an interest in digital — Thomson Electronics and Philips — both have stated that all of their digital television sets will be built in the United States by American workers. This promises thousands of new high-tech jobs for Americans, but if digital television never becomes a reality, neither will those jobs.

The bottom line is that auctions will kill the ability of local stations to make the transition. And that will mean no free digital television, only pay television.

Shortening the Transition Would Cause Serious Problems

Another proposal that would cause serious harm to the digital revolution is the notion of shortening, or accelerating, the transition period in order to more rapidly auction the analog frequencies. While that approach might seem to allow broadcasters to make the transition while also helping to solve our budget problems, in fact it would place a burden on consumers far greater than any revenues that could be obtained from an early auction.

Under one proposal now circulating, broadcasters would be required to turn off the analog channel in 2005. That means that nine years from today, anyone who wants to watch television would have to have either a digital receiver or a converter. Let's look at the penetration levels other new consumer technologies achieved in ten years:

- Ten years after their introduction, only 35 percent of Americans owned CD players
- Ten years after RCA began making color TVs, 29 percent of households had one
- Ten years after the VCR was put on the market, it had a 43 percent market penetration
- Ten years after the video game console was introduced, it had achieved a 15 percent market share

Even if the transition began *today*, it would be folly to suppose that a substantial majority of Americans would have replaced their television sets in only nine years. And, whatever decision the Congress makes about auctions, the earliest that the FCC could begin even assigning licenses would be 1997 and digital service would not be generally available for several years after that.

Thus, the accelerated transition plan under review would mean that consumers would be required by the government to replace almost 250 million television receivers in just over five years, or be

forced to do without television at all. The cost of that "hidden" tax would be many times greater than even the most farfetched estimate of the auction value of the analog spectrum.

Not only would consumers be forced to replace their TVs long before they were worn out, but the cost of new receivers or converters would be far higher than under a market-driven transition. As you know, the price of new electronic technologies drops as manufacturers gain experience and the volume of sale increases. We have seen this trend with computers, with cellular telephones, and with analog television sets. The accelerated transition plan, however, would instead mean that consumers would be forced to buy equipment early in the cycle while the price remained high.

In addition to the burden on consumers, an accelerated transition would place additional burdens on broadcasters and on other parts of our society:

- **Mass Disruption to Electronics Industry**

An abrupt, accelerated transition to digital would cause mass disruptions in the electronics industry, particularly to television retailers. If the transition is too quick, sales of current technology sets will suddenly collapse, long before advanced television receivers were available or usable.

- **Towers**

An FCC advisory committee estimated that between 50 and 72 percent of all existing TV towers will not be able to support a second antenna to broadcast digital television. Therefore, those broadcasters must have their existing towers strengthened or new towers built. Each tower must be individually designed, and the clearance process to erect new ones gets more complicated by the year. FAA, FCC, and local zoning approvals are all required before

construction can begin. New land may have to be found for a tower site. Given that the FCC advisory committee projects the total capacity for tower erection at about 100 a year (twice the current rate), it would take fully seven years just to construct the new towers needed for digital. In other words, some stations might just be at the point of beginning digital operations when their analog service would have to end.

- Supply and Demand

The costs to broadcasters for new towers and other equipment will naturally be affected by supply and demand. And that is particularly important to medium and small markets, where the costs of transitioning to digital will have an even greater impact.

A general rule of thumb is that production costs drop 10% for each doubling of volume. Those broadcasters in smaller markets — like Lincoln and Albuquerque — need enough lead time to allow digital equipment manufacturers the ability to increase production, thus lowering the threshold for conversion costs. If the transition period is artificially shortened, little competition will develop among vendors and the costs will remain unnecessarily high for many local stations.

- Translators

One group of stations that are particularly impacted by digital are those in rural areas, such as New Mexico. Albuquerque stations have about 400 translators that relay their signals over-the-air to 150 communities too far from the tower to receive the picture directly. This provides important access to hundreds of thousands of New Mexicans who would otherwise have no local service at all, and certainly no free television. We also operate eight full-power satellite stations to reach viewers across the market. There is no

way that New Mexico can upgrade their translator and satellite station network to digital overnight — and so they will need time to make the transition so that all viewers can retain access to local television. Spectrum auctions or a shorter transition period will make such a transition literally impossible.

- **Financing**

Stations will need to be able to show that they can afford to make the transition without bankrupting their operations if they ever hope to secure financing to purchase the new digital equipment. Even to convert a station's basic ability to pass through a network signal will cost around \$2 million. A loan just for that portion of the conversion may require an annual payment of nearly half a million dollars per year. In addition, stations will need to convince their lenders to make the loan, even though the station will see no new revenue from converting to digital.

How will that investment compare with our businesses in Nebraska and New Mexico? Albuquerque falls among markets 41-50 in size across the nation. In 1994, the average pre-tax profits per station in those markets were \$2.8 million. Yet look at the 1991 figures in the same markets — where average profits were only \$800,000. Our business is cyclical, a fact that makes it difficult to take on the huge financial commitment that digital TV will require, even without adding to that the costs of bidding for the temporary digital channel.

Similarly, in Nebraska, Lincoln falls between markets 101-110. In those markets, the average station's profits were \$700,000 in 1994. Three years earlier, these stations on average suffered a net loss of \$900,000.

The point is that the transition costs already will tax many stations' borrowing capacity to the limit. Any sort of upfront auctions will make any transition unaffordable altogether. Shortening the transition period will make it even more costly and also act as a further obstacle to conversion.

The bottom line of this discussion is clear — an arbitrary transition period shorter than that envisioned by the FCC will simply add to the financial pressures stations will face in making the conversion, and will seriously endanger their ability to make the transition at all. The losers in that equation are the consumers, who lose access to the benefits of digital technology.

Revenue Assumptions From Auctions Are Wildly Distorted

Another key issue to look at in this economic discussion is how much auctions of the digital channels would produce for the government. Absurdly high estimates of the revenues that would be generated by an auction of the digital TV channels have been suggested. Many of these estimates are based on the market values of existing television stations, and even on extrapolations of values in New York City to every market in the country. Those types of assumptions are unwarranted. The reality is that the value of the digital channels is likely to be low. If they are auctioned off for any purpose, their value will be constrained because the location of the available channels will vary from market to market and the use of all of these channels would be restricted to avoid interference with analog television. If the channels were auctioned off only for digital television service, the likely values will be far lower than have been suggested because starting a new digital television station will be a very risky business.

- New digital stations will have to begin operations before there are any digital receivers in consumers' hand.

- Digital stations unaffiliated with existing broadcasters would also have to develop and pay for new programming that could attract viewers away from existing television stations.
- Over-the-air digital television stations would have to compete with an ever-growing number of competing sources of video programming, many of which are also becoming digital, including cable systems, telephone video systems, digital MMDS and LMDS (the so-called "cellular TV service"), digital satellite services, and even new Internet services.

Because there can be little assurance that digital television stations competing with existing stations will be able to achieve financial success in a reasonable term, the values that could be obtained from such an auction to non-broadcasters would certainly be low. We understand that the Congressional Budget Office (CBO) has estimated that the digital TV channels would raise \$12.5 billion if sold at auction. We believe that this number is unrealistically high. While we do not have a detailed description of CBO's model, they have previously released the general outlines of their model. We believe that their model has two major flaws.

First, they predict very substantial advertising revenues for digital TV within a few years after the beginning of the service. These predicted revenues are overly optimistic. They assume that consumers would buy digital sets and digital converters at unprecedented rates. They fail to take into account increased competition from DBS and other services.

Secondly, the CBO estimates fail to tell the story of the traditional analog TV stations. If viewing of digital television grows rapidly, then viewing of traditional analog television will fall — as will the advertising revenues of analog television broadcasters. The hypothetical profits in the new business must be matched by corresponding losses in the older business. CBO's model of government auction revenues fails to account for any loss of tax revenues as the analog broadcasters decline. CBO's estimates of revenues from any digital TV auctions should be reduced drastically to account for these two effects.

In short, we believe that CBO's projections of revenue are inaccurate, based as they are on erroneous assumptions about the video marketplace.

Another example of how misguided these projections are can be seen in the recent spectrum auction for digital satellite TV spectrum, won by MCI and NewsCorp. In that auction, the consortium was bidding for spectrum capacity almost equivalent to a second TV channel for every station in America. MCI won the auction with a bid of just \$682.5 million, far less than the \$70 billion that groups like the Heritage Foundation have suggested that this amount of spectrum would be worth.

In short, estimates of tens of billions of dollars in new revenue from spectrum auctions are totally without foundation. While we are not economists, we believe we can say that spectrum auctions will not raise significant revenues for the government, while they will have a seriously adverse impact on the digital transition for local stations and consumers. An upfront auction would also mean that analog television service would continue indefinitely, perpetuating the inefficient spectrum technology of the 1930's.

There is a better approach that would both result in more efficient use of our spectrum resources and in higher auction revenues. If we follow the FCC's transition plan, once most Americans have converted to digital TV service, analog transmissions will end and broadcasters will give back one of their channels. At that point, the FCC contemplates "repacking" the broadcast spectrum so that all television stations would occupy only a part of today's television band. We can't do that today because of interference, but the new digital technology is less prone to interference and signals can be placed closer together. The remaining spectrum could then be allocated to other services in broad blocks that would allow bidding for highly valuable

Nation-wide channel assignments. These channels would be more valuable because equipment could be made inexpensively to operate over a few specified channels than over a wide range of frequencies, and because this “clean” spectrum would be free from interference. The revenues that could be obtained from that spectrum would likely dwarf the amounts that the FCC has generated to date. Further, instead of a hodgepodge of conflicting and inefficient digital and analog services, the entire present television band would be filled with efficient digital uses. Following the FCC’s transition plan, therefore, would be good fiscal policy *and* good spectrum policy.

Broadcasters Are Contributing to Balancing the Budget

Those who argue for early auctions of the digital TV channels say that broadcasters should be required to contribute to balancing the budget, supposedly in exchange for the “free” spectrum they have had up to now. In fact, television spectrum has never been “free” and the government and the public have both benefited from the growth of commercial television. Further, the budget bill Congress passed last Fall already singled out spectrum used by television stations for auction, the only existing private use that was forced to move.

Since 1927, broadcasters have been assigned spectrum in exchange for their commitment to serve the public interest. We cannot rehearse here the many ways in which local TV stations serve their communities, but the Committee is aware that television stations are the leading source of news and information to Americans, that local stations provide essential assistance to government and public safety services in every disaster, and that local stations actively participate in bettering each of their communities. This public service is precisely the price Congress expected to receive when it passed the Communications Act.

Moreover, as the television industry has grown and stations have been bought and sold, increasing values have resulted in large amounts of gains, much of which has gone to the government in the form of capital gains taxes. Further, census data show that broadcasting, as an industry, pays a higher than average share of revenues as income taxes. Another effect of auctions would be to reduce those tax revenues as the cost of the licenses would be capitalized.

The budget bill called for raising \$15.3 billion from spectrum auctions, primarily from auctions of 100 MHz of spectrum below 3 GHz. Under the bill, half of that spectrum would come from the spectrum now used by television stations for electronic news-gathering (ENG) and, particularly in smaller markets, for links between stations and translators. Further, under the budget bill, another 35 MHz of broadcasters' ENG spectrum would be reassigned to a new mobile satellite service. Those operators, by the way, would not be expected to pay for their spectrum.

Local television broadcasters, therefore, have already been singled out to bear a substantial amount of the burden of balancing the budget. To also require the spectrum they need for transition to digital service to be auctioned would simply be unfair. It is particularly unjust because other communications industries are converting to digital without any suggestion that their spectrum be auctioned. The cellular industry, for example, will be able to carry eight times the current level of traffic through conversion to digital. Cellular carriers have not, however, been asked to reduce the amount of spectrum they use, or to pay fees, or to participate in auctions for their more efficient channels. The same is true for almost every other service now converting to digital.

Moreover, while those industries will realize new revenues without obliging themselves for any additional payments to the government, the new Telecommunications Act provides that, if broadcasters use digital channels for any subscription or pay services in addition to free, over-the-air broadcasting, they must pay a fee based on the auction value of the spectrum used to provide those services. If we are to have a national policy that requires auctions or spectrum reallocations when digital technology makes more efficient spectrum use possible, then that policy should not be applied solely to television broadcasters.

If Spectrum Revenue Is Truly Needed, Look to Government-held Spectrum

If spectrum auctions are the only way to raise revenue for the government, we would suggest that Congress look at who owns and controls most of the spectrum available — the federal government.

Currently, television broadcasters barely occupy more than one percent of all the spectrum available. Yet all the attention is being focused on us. Ironically, the government itself has access to or controls 94 percent of all spectrum, including 65 percent of the spectrum that currently falls into the most usable category (under 3 GHz).

Several years ago, the National Telecommunications and Information Administration was directed to come up with additional spectrum for private use. While NTIA contended that no spectrum could be made available, the agency did find the spectrum without causing any undue disruption to government functions. Part of the problem is that how government uses the spectrum it controls is a closely-held secret.

The Senate Commerce Committee has already stated its intention to delve into government spectrum at a special coded hearing later this spring. It is at such a closed-door hearing where lawmakers can see first-hand what spectrum is used for and how more efficient use could free up clean, usable spectrum for auctions — and without disrupting American television one iota.

We believe it makes no sense to focus on the small piece of spectrum allocated to television and to ignore the potential of spectrum which government uses.

Other Spectrum Proposals Are Unworkable

Other approaches to digital conversion have been suggested, but all of them would mean poorer service to consumers without any substantial increase in revenues for the government. One suggestion has been to give stations a narrower channel of two or three MHz, instead of the six MHz channel now proposed. Of course, that would prevent stations from ever offering true High Definition television. Further, the Grand Alliance system was designed to use a six MHz channel; changing it would virtually require starting over and throwing out the hundreds of millions of dollars already invested in digital television research. At a minimum, it would take three years to bring us back to the place we are today.

Even then, it is doubtful that very much usable spectrum would become available for auction. These narrower channels would each have to have buffer spectrum around them to prevent interference, and a new channel assignment plan would have to be developed for these channels and the existing analog channels. It is quite possible that very little spectrum could be made available for auction under that plan, particularly in the largest television markets. Thus, little revenue would be obtained, while consumers would be left with far less than optimal

television technology. That approach would also doom America's chances of gaining new trade revenues from exporting digital TV technology as few other nations would be likely to adopt such a technically poor system.

Others have suggested "lopping off" part of the broadcast spectrum up front, and forcing all of the digital transition channels into a smaller portion of the television band. First, those proposals ignore the fact that there are many analog stations operating in every part of the television band. Unless those stations were forced off the air, the amount of spectrum that could be used in large markets for other services would be minimal. Indeed, the engineers have told us that, across most of the East coast, there would be no spectrum that could be used for other services.

At the same time, this proposal would create massive problems in trying to provide both digital and analog service in far less spectrum. As a result, consumers would have to accept higher levels of interference with digital and analog television, and the coverage area of digital stations in larger markets would be materially reduced. Further, this plan would require that many of the translator stations that we now use to serve people in remote communities would have to be turned off at the beginning of the transition, leaving many citizens without access to any local television signals. Again, these proposals may seem attractive, but they would all impose high costs on the public for little, if any, new revenue.

Conclusions

This Committee, Mr. Chairman, is focusing on the value of spectrum and whether we should attempt to leverage the transition to digital television as a way to raise significant revenues for the government.

In this testimony, we believe we have pointed out the communications policy, consumer impact and economic problems that either upfront auctions or accelerated give-back of analog spectrum would create for American consumers and broadcasters in New Mexico, Nebraska, and across the country.

All of us should be looking at this issue from the perspective of the consumer, who ultimately will be paying more to watch television if either of these scenarios should prevail. The fact remains that auctions will kill any hopes that our stations — already facing a huge outlay of resources just to make the transition themselves — can afford to go digital. And if that transition does not occur, we will have taken the best free broadcasting service anywhere in the world and have junked it in a misguided effort to recoup what some people refer to as broadcasters' "corporate welfare."

In fact, providing temporary use of a second channel to allow this transition to occur is not corporate welfare. We will not benefit during the transition, and when we return our analog channels at the end of the transition, the spectrum then can be repackaged and sold to users who will have immediate access to much more valuable spectrum.

It took the FCC and the industries involved nearly ten years to bring us to the brink of a new television future for *all Americans* — a future with more choices, better quality pictures, and sound, and continued free service. We are excited about the prospects of bringing the same benefits of digital television that larger cities will have to communities like Roswell and Lincoln. We urge the Committee not to block this new day for American consumers by creating an impossible roadblock on the information superhighway.

We therefore urge you to reject spectrum auctions — either upfront or via accelerated giveback — and let the marketplace move all of us into a golden age of digital technology.

Thank you.

20

Chairman DOMENICI. Mr. Jerry Hausman from the Massachusetts Institute of Technology.

STATEMENT OF JERRY HAUSMAN, MACDONALD PROFESSOR OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY

Mr. HAUSMAN. What I am going to concentrate on today are the expected results from the various proposals on the early auctions in terms of trying to come up with an economic estimate. I would like to start off with a couple propositions which I hope pretty much everybody is in favor of or agrees with.

The first is that no one can predict the likely outcome of the transition to digital television with any degree of certainty and, therefore, maintaining flexibility in terms of going forward is an extremely good idea.

Second, consumers in the market should decide on the future path of ATV.

And third, neither Government regulators nor Congress should attempt to determine the best path for ATV, in other words, digital television, in terms of programming or video display and market introduction.

As I understand it, the FCC and industry developed a plan which has been discussed today in which the licensees would transition to ATV on borrowed channels within their spectrum and then return one of the television channels when the transition to ATV is complete. What I would like to do today is to consider other proposals that have been put forward and have been discussed by prior speakers and to give my economic evaluation of them.

The first proposal, which I will call the early return option, is a Clinton administration proposal. It has some features in common with the FCC proposal, but as Mr. Irving said, it would require an accelerated give-back of the so-called analog return station. In 2002, an auction would take place and the spectrum would be relinquished in 2005.

Once this occurred, the spectrum could be repacked into a smaller spectrum band and we would have 150 megahertz of clear and contiguous spectrum that could be used flexibly through the United States I agree with Mr. Irving and some of the prior speakers, Mr. Moore from the CBO, that this would be quite valuable spectrum, certainly for uses such as mobile telecommunications, given its nationwide feature.

Prior to today, the CBO had scored this to be approximately \$6 billion, and today, Mr. Moore raised that to \$11 billion. As Mr. Irving said, however, the OMB places a considerably higher value on this analog spectrum and, as he said, they see it as \$17 billion. I will give my reasons later for why I think the \$17 billion is likely to be on the high side.

The second proposal, which is the up-front auction, we have also heard about today. This would be an auction perhaps as early as 1997 of 80 megahertz on average per market. This spectrum would not be contiguous, not available throughout the United States, and likely would be used for analog television. As Mr. Moore testified today, the CBO scores this at \$12.5 billion, which I think is very much on the high side.

As we are sitting here today, what does an economist do? I agree with Mr. Moore that it is very difficult. The future is uncertain. If he and I knew for sure, we would be out buying stock today, sending our kids to college with our proceeds. But what an economist tries to do is to say, let us see what the market has to say about this because the market should give you an indication. The market is not perfect, but when people put their money on the table, they are spending their money or their stockholders' money and that probably gives you a pretty good indication.

So what I have done is I have looked at the sales of all UHF television channels over the last 5 years. One of the things I do in life is I am an econometrician, which uses statistics to look at economic data. I have taught that at MIT for a long time. I am going to use actual market data to come up with an estimate rather than using sort of a business model or various other approaches that CBO has attempted.

My basic conclusion is that the \$12.5 billion for the early auction is much too high and that I certainly believe that the auction of the give-back spectrum, the 150 megahertz, will have a significantly higher value than the 80 megahertz of spectrum give-back. So let us not worry about discounted present value and stuff like that. I can take care of that. That would just complicate matters.

It comes down to this. We are going to auction 150 megahertz of clear nationwide spectrum or we are going to auction 80 megahertz of unclear nationwide spectrum. Most economists and probably most people would say, if you auction twice as much of one thing as another thing, it is going to be worth more money.

The CBO, prior to today, had said, no, it is only going to be worth half as much money, which I find as an economist to be hard to accept. Today, they have changed their estimates and they are now very close to each other, although the 80 megahertz they are still scoring at greater than the 150 megahertz. So I think they have just the opposite result of what I, as an economist, would come up with, and I think most people thinking about the problem would also come up with.

How did they do this? How did they come up with this estimate? They assume that there will be a first mover advantage. That is just a fancy economics term, and I will explain it very simply. We are going to have an auction in 1997 and there is going to be a land rush, sort of like in 1849 in California, because the broadcasters are going to say, if I do not get in there early, I am never going to get in and I will be left behind forever.

How do we test that? The way we test that is, let us take a look and see what UHF channels are being sold for, because I could buy a UHF channel today in various parts of the country—they get sold all the time—and if I get that UHF channel, I can then change that to digital television when I want to.

In Boston, where I am from, NBC is not going to change Channel 7 all at once from analog to digital because people would be very upset, including myself. We like to watch basketball games. But there are a lot of UHF channels in places like Boston which are, at best, marginally profitable. They make essentially no money. In fact, there is one dark UHF channel in Boston as we sit here today.

Or go look in Wheeling, WV, where I was brought up. There are a lot of UHF channels that are not being used. If I wanted to buy one of those, if I thought digital was going to do very well, I could buy it and switch over to digital next year or the year after, whenever the FCC allowed me to, and there would not be that many people that would be that upset because the channels are not even being used now, or at best, they are not getting a very big viewership.

When I do this and look at all the UHF stations, I find that the value of them throughout the United States is about \$3.5 to \$4.5 billion. That is a lot less than the \$17 billion that we heard from the Administration earlier today and it is also a lot less than the FCC.

The FCC looked at essentially one sale of one station in New York City, WNYC. Even we in Boston think that New York is different from Boston, but certainly people in Wheeling, WV, think that New York is a lot different than Wheeling, WV. So that is like taking a sale of one block on the corner of 55th and 5th Avenue—that is where an expensive hotel is—and saying, we are going to use that estimate for the whole country. To me, that does not make sense, and therefore, when I looked at the sale of all the stations over the last 5 years, which is approximately 266 stations, I think I can come up with a much better estimate.

Therefore, I do not think there is going to be this land rush and there are a lot of marginally profitable stations out there today. I do not see them really bidding very much.

So in summary, I do not agree with the CBO's expectation that the 80 megahertz are going to come out with a higher bid than the 150 megahertz. In fact, I think it is just the reverse.

Now, I would like to turn to the Administration and the OMB's estimate of \$17 billion. I will be the first to admit that it is uncertain and \$17 billion could be the right number, but the problem I have with the Administration proposal is, at least as I understood it prior to today, and I have not heard anything different, is that what they are going to recommend is to hold broadcasters responsible for any shortfall of the \$17 billion. So if you accept a channel, you have just written a blank check which says when this auction takes place, any shortfall, you have to pay.

In finance and economics, we call this a put option. That is a derivative. Those do not have a real good reputation on Capitol Hill. But what you have just done is when you accept the digital spectrum, you have a put option and if the money does not come up, you end up owing the money. It does not seem to me that that is a good way to do spectrum allocation and policy in the United States.

Just to end up, what I would like to point out is that free television or over-the-air television has one very important difference than many other economic goods and that is that it is a public

good. It is provided free to people who want to watch it and people who want to watch it get consumer welfare from doing it. Otherwise, they would not be watching television.

Therefore, I think we need to be very careful in terms of policy and we do not want to end up with an implicit tax on poor people. The people that I would not expect to have transitioned over to digital television perhaps at the time of the accelerated give-back, who do we expect those people to be?

I will have a digital television. My 14-year-old daughter will guarantee that we have a digital television. But there are a lot of poor people out there who I expect not to have it, and it seems to me that it would be a regressive tax policy, and, in fact, a hidden tax policy of the Administration to force those people to spend the money either on cable or to have no television at all.

I would like to just end up and say that I think that Senator Gramm hit the nail on the head to some extent when he said, when you start selling assets, you are not solving your budget problems. I think there is a real danger here that if the Administration proposal goes forward, what is going to happen is we are going to be solving, or partly solving the budget problems by having a hidden tax on poor people who will not have converted to digital television. I do not think that is a way we should be doing budgetary policy. Thank you.

Chairman DOMENICI. Thank you very much.

[The prepared statement of Mr. Hausman follows:]

PREPARED STATEMENT OF JERRY A. HAUSMAN, MACDONALD PROFESSOR OF ECONOMICS, MIT

Expected Results from Early Auctions of Television Spectrum

As I understand the current policy discussions, there is a general consensus among policymakers, regulators and the broadcast industry that it would be in the public interest for free over the air television to transition from the current analog system to digital advanced television (ATV). Certain characteristics of this transition seem relatively unconstitutional. These are that: (1) no one can predict the likely outcome of the transition to digital with any degree of certainty; (2) consumers and the market should decide the future path of ATV; and (3) neither government regulators nor Congress should attempt to determine the "best" path for ATV in terms of programming or video display and market introduction.

What Congress and government regulators do need to decide is the method by which ATV channels should be assigned. As I understand it, the FCC and industry developed a plan over the past decade whereby television station licensees would transition to ATV on borrowed channels within their spectrum allocation and then return one of the television channels when the transition to ATV is complete, determined as a factor of time or as a factor of ATV service penetration (the "FCC/Industry Option"). Two proposals for early auctions have now surfaced. These proposals have not been formalized and are not publically available in full, but both have been analyzed by the Congressional Budget Office and one by the Office of Management and Budget. It is to these that I now turn.

Early Auction Proposals

The first proposal (the "Early Return Option") has been forwarded by the Clinton administration. Like the FCC/Industry Option, the Early Return Option would allow current TV station operators to use additional sufficient spectrum within their current broadcast allocation (6 MHz per current channel) to provide ATV. However, unlike the FCC/Industry proposal, it would require an accelerated "five-back" of the current analog spectrum used for TV, the "analog return spectrum."¹ In 2002, an

¹ The broadcaster could return either its current analog channel or its new digital channel and switch its digital transmission to its old analog channel.

action would be held for the analog return spectrum which would be relinquished for actual reuse in 2005. Once the analog return spectrum had been vacated, ATV channels could be repacked into a smaller spectrum band. This repacking would leave approximately 150 MHz of cleared and contiguous spectrum that could be used flexibly throughout the United States² because this spectrum would not be interspersed with television channels, it would be open to a wide variety of uses, including mobile telecommunications. The CBO has "scored" the value of this auction to be approximately \$6 billion (as of February 23). The OMB places a considerably higher value on the analog return spectrum. Its current estimate (as of March 5) is \$17 billion, approximately three times higher than the CBO estimate.

A second proposal (the "Up-front Option") is for an immediate auction in 1997 of the spectrum within the broadcast allocation that the FCC/Industry Option would allow current TV station operators to use for ATV.³ The amount of spectrum auctioned under the Up-Front Option would vary from market to market and is estimated to average approximately 80 MHz per market. The spectrum would not be contiguous nor available throughout the United States instead, the auctioned channels would be interspersed with analog TV channels and different channels would be auctioned in different markets. The CBO has scored the Up-Front Option at \$12.5 billion (as of February 23), assuming that it would be used for multiplexed digital TV. The CBO has its two scoring valuations of the same dollar with no discounting or inflation assumptions involved. Nor does the scoring take into account the social welfare value added by free over the air television—a value that has been recognized by economists for more than 40 years.⁴

Critique of Early Auction Proposals

A. The CBO Incorrectly Ranks the Two Early Auction Proposals

The primary purpose of my testimony today is to challenge the CBO's assumptions regarding, and monetary ranking of, the two early auction proposals. Most economists would expect that the Early Return Option to raise more money than the Up-Front Option. This is for two reasons. First, the Early Return Option would auction 150 MHz of contiguous, nationwide spectrum whereas the Up-Front Option would auction about half as much spectrum (80 MHz) which would be splintered in 6 MHz bands, scattered across the country, and subject to interference protections due to broadcast TV. Second, under the Early Return Option, spectrum could be used flexibly for multiple uses on nationwide channels while the Up-Front Option spectrum would have more limited uses, being necessarily "local" and constrained by neighboring TV channels.

However, the CBO's analysis forecasts the opposite result of what I would expect. It suggests that the Up-Front Option would yield higher auction revenues than would the Early Return Option on the basis of two primary assumptions with which I cannot agree. In essence, these assumptions lead the CBO to underestimate the value of the Early Return Option and to overestimate the value of the Up-Front Option. With respect to the Early Return Option, the CBO posits that the government will auction off an additional 120 MHz of new spectrum between 1997 and 2002. This additional supply of spectrum and a downward sloping demand curve lead the CBO to underestimate the value of the analog return spectrum. While some price decrease would be expected, the price decrease will not be nearly what the CBO predicts. Therefore, I believe that the estimate of the analog return spectrum value is too low.

The experience over the past 18 months with auctioning broadband PCS spectrum suggests that the value of the Early Return Option spectrum will be much higher than the CBO estimates. The PCS spectrum has led to approximately \$14 billion in winning bids for 90 MHz of spectrum. This amount is more than twice as much as what the CBO estimates the analog return spectrum will fetch for 50 percent more spectrum than was on the block in the PCS auction. The release of 120 MHz of additional spectrum between 1997 and 2002 might reduce the value of the analog

² Depending on what is decided about public television, this could be reduced. The number also depends on the manner in which ATV channels are assigned.

³ My understanding is that the CBO assumes the spectrum will be used for ATV. To the extent that it is used for other purposes, the amount of useable spectrum would be decreased and its value diminished because of interference constraints that would be imposed by the existing television stations.

⁴ Implementation of the Up-Front Option could have significant detrimental effects on the nationwide roll-out of ATV and thus on the public good that broadcast television affords. Similarly, a substantial probability exists that the Early Return Option would result in the cut-off of analog television when many low income households and multiple television households will not yet have purchased replacement digital TV sets or converter boxes. These households would experience a significant loss of consumer welfare that should be borne in mind.

return spectrum somewhat, but not by a factor of more than two, given all the other considerations.

I have even more disagreement with the CBO estimate for the Up-Front Option spectrum, which I consider to be too high by a potentially significant amount. The CBO comes to its high estimate via the assumption of a "first mover" advantage. It assumes that current over the air TV broadcasters (and perhaps other potential entrants) will bid large amounts for the digital TV spectrum on 1997 because they fear being left behind by the "first movers" who might maintain an advantage of early entry into the foreseeable future. I believe that the first mover rationale is inconsistent with the fundamental economics of over the air broadcasting.

If there were a first mover advantage to be had, one would assume that there would be great demand for UHF channels as a way to get into television spectrum. Purchasers of the UHF channels would expect to convert them to digital uses once the transition were underway. Thus, one would expect to see sales prices for recent UHF station sales that approached the value the CBO expects to see in the bidding for the Up-Front Option spectrum. The numbers do not bear this out. I have conducted an econometric analysis of the sale of all UHF stations for the period 1990–95.⁶ While occasional sales of stations in large cities, such as the 1995 sale of New York's WNYC for \$200 billion, are quite high, my econometric results predict an overall value for all UHF stations to be approximately \$3.5–\$4.5 billion. This estimate is about one-fifth as high as the value received for the WNYC sale on a per population basis. These results are consistent with the much lower economic returns earned by UHF stations outside the top 30 markets. This figure of \$3.5–\$4.5 billion is therefore probably a much better indicator of the market interest in over the air broadcasting than is the indicator CBO has chosen based on its arguably incorrect first mover assumptions.

Rather than rush to bid for channels when they have not rushed to buy UHF analog channels that would serve just as well, I would expect many broadcast station owners to take a "wait and see" attitude to an auction held in 1997. Or they would bid relatively low amounts. The marginally profitable UHF stations, even in large markets like Boston, would not have an economic incentive to undertake the relatively large investment to convert to ATV if they must also pay an auction price. It is unlikely that the additional channels which would be broadcast with ATV would make such an investment worthwhile, especially when programming costs for these additional channels are taken into account.

The main potential drawback to a wait and see strategy from the potential ATV broadcaster's strategic viewpoint is that other non-television spectrum users might decide to purchase the spectrum at high values. However, once these potential bidders would know that the FCC will auction a minimum of another 120 MHz of spectrum drawn from other sources, I find this outcome unlikely. Alternatively, the ATV spectrum might be limited to television use which eliminates this potential drawback.

Thus, in summary, I do not agree with the CBO's expectation that there will be significantly higher bids for the MHz of fractured, interference-limited spectrum drawn from the Up-Front Option than for the 150 MHz of nationwide, contiguous spectrum drawn from the Early Return Option. Indeed, I expect the 150 MHz of spectrum under the Early Return Option to have a significantly higher value than the 80 MHz of spectrum under the Up-Front Option.⁶

B. The OMB Overestimates the Accelerated Analog Auction Value

As stated above, the OMB estimated the value of the Early Return Option spectrum to be \$17 billion. While I agree with the OMB that Early Return Option spectrum will be more valuable than Up-Front Option spectrum, I believe that \$17 billion may be too high an estimate. The extent to which the estimate is too high becomes relevant to the fortunes of ATV because the Administration has recommended holding digital ATV providers responsible for any shortfall from \$17 billion. Thus, any difference between the amount the analog return spectrum be predicted to yield and the amount it actually yields is a measure of the added financial cost broadcasters will attach to the conversion to ATV. This added burden, which is a direct product of the OMB's overestimate, could have significantly negative effects on the future of digital television in the United States.

⁶The sample size is 266 station sales over this time period. I did not exclude affiliated UHF stations, although that step might have been justified.

⁶Some changes would need to be made if discounting of payments between 1997 and 2002 were considered. However, the CBO has used no discounting, and a number of proposals allow for delayed payment of the spectrum.

The OMB estimate is based on an earlier estimate of Dr. Robert Pepper of the FCC. Dr. Pepper applied the amounts earned at the PCS auctions to the analog return spectrum. Thus, extrapolating from the broadband PCS auctions which had at the time garnered about \$7 billion for 60 MHz of spectrum, he assumed that the 150 MHz of analog return spectrum (about 2.5 times as much) would garner about \$17.5 billion. As discussed in Section A above, this number fails to take into account further spectrum releases and the attendant price decrease of the analog return spectrum. The effects of added spectrum supply should not be expected to decrease the price of the Early Return Option spectrum in excess of a factor of two (as OMB suggests), but should be expected to have some effect.

Dr. Pepper and the OMB further supported their estimates by using the sale of WNYC in New York as a baseline for their predictions. I stated above, the single data point of the sale of an unusually valuable New York City property should not be used to estimate the value of the digital ATV spectrum. Estimates based on this one data point would be too high by about a factor of five.⁷ This single sale is as unreliable a guide to spectrum value as would be the price of a recent sale of property on Fifth Avenue in midtown Manhattan to property values in downtown Boston, let alone downtown Wheeling, WV, where I grew up. Indeed, UHF stations currently are unused in Wheeling so that their value is extremely low, near zero, in fact. Again, I believe that all UHF station sales, not a single sale in New York City, are likely to provide a much more accurate estimate of likely auction values for the analog return spectrum.

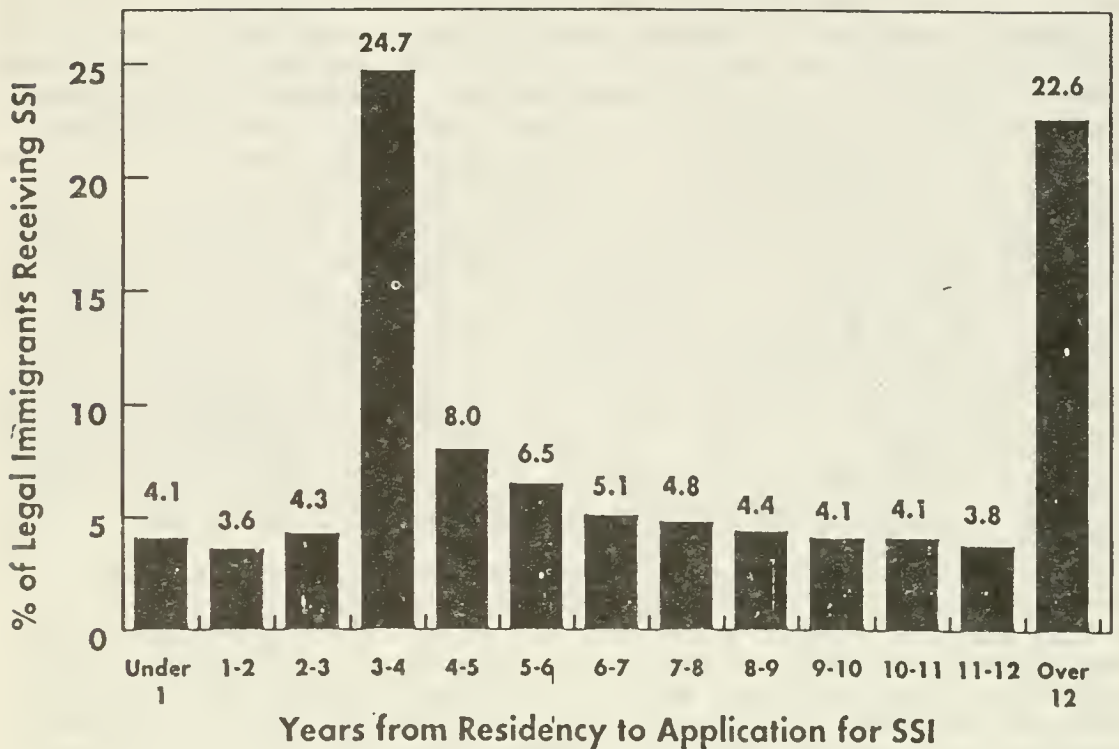
Given the uncertainty of the value of the analog return spectrum, the Administration's proposal to hold ATV providers liable for any shortfall below \$17 billion is an unsound allocation of economic burden. Such liability is likely to delay the adoption and broadcasting of ATV in the United States. In effect, the Administration is asking broadcasters to forecast bidding activities to take place in 2002 and to assume the significant risks that the costs and quality of technology, the availability of programming, and associated consumer demand will make ATV feasible and adoption relatively swift. This proposal is the equivalent of asking broadcasters for a put option on the spectrum value of \$17 billion. If the auction price is above \$17 billion, nothing happens. If the auction value is below \$17 billion, the put will be exercised. Since the value of options increase with two factors—the underlying variance of the true valuation and the amount of time until the option expires—the value of the implicit put option is quite high. Current broadcasters are likely to be leery of selling this put option to the Administration in return for the use of the ATV spectrum. Instead, many broadcasters are likely to take the "wait and see" approach which I discussed above. The result will be a delayed adoption of ATV with an increased probability that ATV will not be successful in the United States.

Conclusion

The most rational expectation of value from the two early auction proposals is that the Early Return Option of auctioning 150 MHz of contiguous, nationwide spectrum will be worth more (even accounting for the time value of money) than the Up-Front Option of auctioning only 80 MHz of fractured, regionalized spectrum that must accommodate existing broadcast channels. The value of the Early Return Option is higher than the CBO estimate of \$6 billion but probably lower than the OMB estimate of \$17 billion. The value of the Up-Front Option is significantly lower than the CBO estimate of \$12 billion which was based on optimistic forecasts and assumptions which are not consistent with actual market data on sales of UHF spectrum. One final point to keep in mind is that all auction proposals should consider the fact that free over the air television is a public good that provides a considerable social welfare value that can be diminished by a transition to ATV that occurs too early.

⁷The WNYC sale was \$207 billion. For the sample of 280 UHF station sales the median sale price was \$3.4 billion with the mean at \$11.0 billion. Thus, the data demonstrate that the sale of WNYC in New York is far different from UHF station sales in other parts of the United States.

When Do Immigrants Apply for SSI?



SOURCE: Congressional Budget Office

Chairman DOMENICI. Mr. Moore, before we go to the next witness, Mr. Hausman has indicated a rather significant criticism of your method of evaluating. On the 80 versus 150, he came up with some conclusions that he said were very logical. What that means is what you have done is very illogical, I assume. I would ask you to quickly explain that, if you could.

Mr. MOORE. Of course, we are going to differ with Dr. Hausman on this one and I am going to ask Dr. Beider to provide an answer.

Chairman DOMENICI. Would you please?

Mr. BEIDER. Certainly, Mr. Chairman. There is no need for proportionality. You would not necessarily expect 150 megahertz to be worth roughly twice as much as the 80 megahertz because these are completely separated markets. The 150 megahertz under current FCC rules would be available for nonbroadcast uses. The 80 megahertz under the up-front auction plan would be available primarily for broadcast purposes. They are different markets and the prices in those two markets need have no direct correlation.

Dr. Hausman has indicated that our estimate is based on some kind of first-mover advantage. Let me clarify that a little bit by saying that there is no hidden assumption in our estimate of the up-front auction proposal. We simply estimated how much money we thought broadcasters could make in that digital television market and then assessed how much they would be willing to pay for that opportunity.

Dr. Hausman's point became relevant in comparing the up-front auction of the digital channels with the analog give-back auction. When we met with Dr. Hausman, he asked us in essence, that if digital television is such hot stuff that people would pay \$12.5 bil-

lion for 80 megahertz of it, if they could in principle use the 150 megahertz for that same purpose, why would they not give even more money for that?

Our explanation is that the opportunity to make money in the year 2005, when there would be digital broadcasters already in place, would not be nearly as great as it would be if you were the first guys on the block in 1997 or 1998. You could call that a second-mover or late-mover disadvantage, if you like. It is another version of our argument that the more spectrum is made available for a given purpose—the more competition—the lower the auction receipts.

I could go on, but perhaps we should come back later.

Chairman DOMENICI. Thank you very much. What was your name again?

Mr. BEIDER. I am Perry Beider.

Chairman DOMENICI. What is your expertise in this area?

Mr. BEIDER. I am more or less an economist. My degree is in engineering-economic systems from Stanford.

Chairman DOMENICI. That is good enough. [Laughter.]

Might I just take 1 minute to say to you, Dr. Hausman, I think in your last remarks you have expressed the concerns of almost everyone on this committee, that in doing this, we do not want to levy a hidden tax on the poor people of this country. It is obvious there is already a great disparity in what they can afford, even in the simple system now with cable and free. You see the numbers, and you see them in some of the poorer States. We still have 40 to 45 percent who are not even on cable.

We all have a concern that we not do this in such a way that it becomes that hidden tax, and I will express some concerns about the timeliness of it later with some questions to you.

Let us proceed with our last witness, Mr. Hazlett. We are glad you are here and we are sorry you had to wait so long.

STATEMENT OF THOMAS W. HAZLETT, VISITING SCHOLAR, AMERICAN ENTERPRISE INSTITUTE, AND DIRECTOR, PROGRAM ON TELECOMMUNICATIONS POLICY, UNIVERSITY OF CALIFORNIA, DAVIS

Mr. HAZLETT. Thank you very much, Senator. I come generally from California. This year, I am in Washington. I also, as a graduate of UCLA, have to mention the reigning national basketball champions, the UCLA Bruins.

Senator EXON. I object, Mr. Chairman. [Laughter.]

Mr. HAZLETT. The situation is somewhat fluid and I thought I would get that in there.

Chairman DOMENICI. I just was going to tell you, so you would know, I was asking Senator Exon something about your Big Red comments and he took credit for them. He said he told you to do that.

Mr. SHRIER. He deserves credit for them. Thank you very much.

Mr. HAZLETT. I would like to comment in a slightly more global perspective about the policy that is involved with so-called advanced television, sometimes called digital television or sometimes called high-definition television. The plan crafted by the FCC that is now in place for this transition is a relic of the top-down regu-

latory structure which has dominated the broadcasting industry since 1927 and the Radio Act.

The DTV plan, adopted in 1992, would utilize the FCC's television allocation table adopted in 1952, 44 years ago today, as the basis for the next generation of television services and would mandate what frequencies television broadcasters use, what standard is employed, how many channels or signals are delivered to consumers. Most notably, it does not allow for flexibility for licensees in selecting the services provided to the public. Those are, in fact, dictated by the commission.

Chairman DOMENICI. Mr. Hazlett, whose plan is that that is predicated on the very old law?

Mr. HAZLETT. The FCC's current plan is within the 1952 television allocation table.

Chairman DOMENICI. Thank you very much.

Mr. HAZLETT. This is a hugely risky undertaking under which a very valuable natural resource, radio spectrum, will almost surely be locked into inefficient uses and outmoded technologies, and I agree very much with Professor Hausman's statement that this area is dynamic, fluid, and filled with uncertainty about what future demands will be and what technologies will most efficiently meet them.

The risk involved here is seen in the current mess which has been made of the television band. That band consists of 402 megahertz of prime spectrum. Today, that band delivers about 13 channels of broadcast television service in the typical U.S. market. Many of these 13 channels, of course, come in only faintly without the assistance of cable television retransmission.

Yet given the six megahertz of band width allotted for today's analog television signals, the total spectrum requirement is only about 80 megahertz per market. Because of the way transmitters are spaced and power assignments determined and due to stifling rigidities in the way licenses are defined, we have managed to massively over-allocate, or if you look at it the other way, under-utilize the television band, which is five times the required size.

Ironically, the switch to digital transmissions, which the Commission's ATV plan seeks to affect, will only make the inefficiency in this band more intense. There is little doubt that all the television broadcast services now available to customers could, even at sharply higher signal quality levels, be transmitted over about 40 megahertz, or one-tenth the television band.

The simplest way to institute broadcast efficiencies would be to introduce flexible use of broad bands, much greater than the six megahertz slices we give today, and issue these as overlay rights, much as we have done in the PCS proceeding.

Current analog broadcasters could and probably should be vested in their current license assignments indefinitely, thus allowing the existing television formats to remain undisturbed. This is very important. All the problems about going off the air, all the things about poor people not getting television, that problem can be solved directly by vesting the current analog transmissions on their licenses. Leave that undisturbed.

In fact, you could even require that that service be provided. It is interesting that free over-the-air television, as it is called, adver-

tiser-supported television, is not required under the 1934 Communications Act. That is a selection made by broadcasters because it is the way they maximize profitability.

These new overlay rights could be auctioned off in large blocks of perhaps 40 to 50 megahertz in band width in local, regional, or national licenses. These rights would be flexible and broadly defined. Licensees would be permitted to provide advanced television services on the Grand Alliance standard as well as other broadcast and telecommunications services, including high-speed Internet access for home or office computers.

The overlay rights licensees, having powerful economic incentives to discover the keenest consumer demands and the most cost-effective technologies available to satisfying them, will then act to clean up the television band in dramatic ways. Far greater economic activity will be generated by this competitive solution to the television band allocation problem than the command and control scheme currently in place. Many of these efficiencies, I think, were very eloquently put on the table by Secretary Irving.

We talk about all the new telecommunications services which are possible but are possible in the short run, not in the long run, if a much more liberal regime for license allocation is adopted in the television band.

The specific issue of lending broadcasters their current licenses and then reclaiming them for FCC reallocation at some later date is interesting. Paradoxically, it gives broadcast licensees both too much and too little. It gives licensees too much because an interest-free loan is really a gift of interest. Give me some property in downtown Manhattan, or even suburban Philadelphia, and I will be very happy to return it to you in the same condition I got it in 12 years, and thank you very much.

On the other side, the scheme gives broadcasters too little. By requiring that they broadcast analog television signals and only analog television signals, broadcasters are limited by bureaucratic controls to providing much less service to the public than is economically efficient. Even if flexibility is granted, the fact that licensees have to vacate in a few years will discourage investment to establish new services on these channels. The broadcasters themselves have argued that they can transmit the current analog television signals and digital telecommunications on the same existing band right now, but if we adopt a top-down scheme, as such we are talking about, those kinds of opportunities are moot.

Worse yet is the fact that the so-called return channel is tied in the regulatory world to a new so-called digital channel. That is, the give-back plan only makes sense in a world in which the FCC continues to micro-manage, calling the economic shots far into the future, the television band, purporting to know what consumers want and how best to give it to them. The history of this sort of industrial policy in telecommunications regulation is, one can safely say, a prime exhibit in the case against central planning.

In short, current broadcasters ought to be able to keep what they are licensed to use now, and in any case have typically purchased in a secondary license market, and be given flexible use of that channel. The new license assignment process, however, ought to seize the moment, to break free the inefficiencies imposed by the

FCC's 1952 television allocation table, which, by the way, did kill the fourth network in existence at the time, the Dumont network, which went dark in 1955 as a direct result of the parsimonious allocation of licenses and the inefficient top-down regulatory structure.

New licenses ought to be broad spectrum bands with flexible use and broad service definitions and should be sold by competitive bid in an expeditious manner. Thank you very much.

Chairman DOMENICI. Thank you very much.

[The prepared statement of Mr. Hazlett follows:]

TESTIMONY OF THOMAS W. HAZLETT¹
 TV BROADCAST LICENSE ASSIGNMENTS
 U.S. SENATE BUDGET COMMITTEE HEARINGS
 14 MARCH, 1996

- *Issue 1: The current Federal Communications Commission (FCC) plan under existing law to loan broadcasters spectrum for an indefinite period to facilitate a mandated transition from an analog signal to a digital signal for television broadcasts.*

The FCC plan now in place for the introduction of Advanced Television (ATV), sometimes called Digital Television (DTV) or High-Definition Television (HDTV), is a relic of the top-down regulatory structure which has dominated the broadcasting sector since the 1927 Radio Act. The DTV plan adopted in 1992 would utilize the FCC's TV Allocation Table adopted in 1952 as the basis for the next generation of television services, and would mandate what frequencies television broadcasters use, what standard is employed, how many channels (or signals) are delivered to consumers. Most notably, it does not allow for flexibility for licensees in selecting the services provided to the public; those are dictated by the Commission.

This is a hugely risky undertaking under which a very valuable natural resource, radio spectrum, will almost surely be locked into inefficient uses and outmoded technologies. That is seen in the current mess made of the TV band, consisting of 402 MHz of prime spectrum. Today, that band delivers about 13 channels of broadcast TV service in the typical U.S. market, many of which come in only faintly without the assistance of cable television retransmission. Yet, given the 6 MHz of bandwidth allotted for today's (analog) TV signals, the total spectrum requirement is only about 80 MHz per market. Because of the way transmitters are spaced and power assignments determined, and due to stifling rigidities in the way licenses are defined, we have managed to massively over-allocate (or under-utilize) the TV band, which is five times the "required" size.

Ironically, the switch to digital transmissions, which the Commission's ATV plan seeks to effect, will only make the inefficiency in this band more intense. There is little doubt that all the television broadcast services now available to customers could -- even at sharply higher signal quality levels -- be transmitted over about 40 MHz, or one-tenth the TV band. The simplest way to institute broadcast efficiencies would be to introduce flexible use of broad bands (greater than 6 MHz) issued as overlay rights. Current analog broadcasters would be vested in their current license assignments indefinitely, thus allowing the existing television formats to remain undisturbed. The overlay rights could be auctioned off in large blocks of, perhaps, 40-50 MHz, in local, regional, or national licenses. These rights would be flexible and broadly defined: Licensees would be permitted to provide ATV services on the Grand Alliance standard, as well as other

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broadcast and telecommunications services, including high-speed internet access for home or office computers. The overlay rights licensees, having powerful economic incentives to discover the keenest consumer demands and the most cost-effective technologies available to satisfy them, will then act to "clean-up" the TV band in dramatic ways. Far greater economic activity will be generated by this competitive solution to the television band allocation problem than the command & control scheme currently in place.

The specific issue of "lending" broadcasters their current licenses, and then reclaiming them for FCC-reallocation at some later date, is interesting. It, paradoxically, gives broadcast licensees both too much and too little. It gives licensees too much because an interest-free loan is really a gift -- of interest. Give me some property in downtown Manhattan, or even suburban Philadelphia, and I'll be very happy to return it to you in twelve years. And thank you very much. But, on the other side, the scheme gives broadcasters too little. By requiring that they broadcast analog TV signals and only analog TV signals, broadcasters are limited by bureaucratic controls to provide much less service to the public than is economically efficient. (Even if flexibility is granted, the fact that licensees have to vacate in a few years will discourage investment to establish new services on these channels.) Worse yet is the fact that the so-called return channel is tied, in the regulatory world, to a new so-called digital channel. That is, the give-back plan only makes sense in a world in which the FCC continues to micro-manage -- calling the economic shots far into the future, at that -- the television band, purporting to know what consumers want and how best to give it to them. The history of this sort of industrial policy in telecommunications regulation is, one can safely say, a prime exhibit in the case against central planning.

In short, current broadcasters ought to be able to keep what they are licensed to use now (and, in any case, have typically purchased in the secondary license market), and be given flexible use of that channel. The new license assignment process, however, ought to seize the moment to break free of the stultifying inefficiencies imposed by the FCC's 1952 TV Allocation Table. New licenses ought to be broad spectrum bands, with flexible use and broad service definitions, and should be sold by competitive bid in an expeditious manner.

- ♦ *Item 2: The differences between the President's Proposal to accelerate the FCC transition schedule with an auction of returned analog spectrum in 2002 and a proposal to replace the FCC plan with an immediate auction of the broadcast spectrum that was to be loaned to the broadcasters.*

Auctioning those assignments currently held by broadcasters is, now or in the future, a step in the wrong direction. That is seen when we focus on the appropriate goal for telecommunications policy: maximizing consumer welfare. This requires the promotion of competition and innovation, and this is achieved by allowing the maximum number of entrants -- and uses -- of the available radio spectrum. The licenses already held allow some services to be delivered today -- that's very good. We ought do more of that. But huge swatches of bandwidth are held in "spectrum reserves," and the bands now in use are strictly zoned, limiting their usefulness. The immediate step should be to introduce flexible use for those licenses already issued, making their operating licenses (the current FCC license) much closer to "spectrum

licenses." This will allow the various providers of wireless service to compete directly, both within the same allocation, and across allocations. Next, access to unused bands of spectrum should be granted to new competitors. The ultimate goal, of course, is to drive down the price of spectrum access (an input) and to thereby maximize the value of services delivered to consumers. One should note to members of the Budget Committee that this policy will also allow economic activity to flourish as radically more efficient telecommunications services are offered individuals and businesses. Tax revenues will respond positively.

Taking spectrum out of use and putting it back at the FCC, where a political process will kick in to determine how those frequencies can be utilized, is backwards. Once the spectrum is being used to serve the public, and an effective manager of a particular frequency has been procured ... the person of the licensee, the efficient approach is to leave well enough alone. Keep the license where it is assigned, and introduce incentives for more economical treatment of scarce spectrum by expanding the effective control of that licensee/spectrum manager. That is done through liberalization of the rights associated with a license assignment. Ideally, these should be expanded to encompass all non-interfering uses of the radio spectrum space defined (implicitly and explicitly) in the current FCC operating permit.

- *The economic efficiency of requiring all broadcasters to make investments necessary to transition to digital technology compared to allowing each broadcasting enterprise to choose whether to switch from analog technology.*

Allowing the calculated judgments of investors risking their own money is the more reliable method for transitioning to the new technology. The simple fact is that it is currently unknown how efficient digital transmissions will be in meeting consumer needs. That is why the trial and error of the marketplace ought to be given full responsibility for finding out. The FCC surely cannot divine what the optimal deployment of resources will be. Mandating 16-year change-out plans for an entire industry -- an entirely *dynamic* industry at that -- is a recipe for public policy disaster.

The way to conduct the set of relevant experiments with the new technology is to move to a more competitive system, an opportunity clearly afforded by the coming allocation of ATV licenses. A liberal licensing scheme, as I have suggested, will lock in place the proper incentives to promote appropriate risk-taking in a discovery process that will tell us how to most efficiently satisfy the public's demand for digital television. The system of free licenses, conditioned heavily by FCC rulemakings and resulting in rigid rules for broadcaster services and delivery systems, gives away both too much and too little. We need to grant broad rights to spectrum access, so as to allow licensees to take into account all the opportunity costs of their decisions. At the same time, we ought to end the zero-priced award of new licenses not only because it is an inefficient assignment scheme which has produced excessive rent-seeking and politicization of the licensing process, but also because "free" licenses always come with strings attached. Those are ties that bind markets in exceedingly inefficient ways. Fully flexible (and broad-band) spectrum permits for "television" spectrum ought to be sold at auction, because "free" licenses cost the public way too much.

the Broadcast Economist

Free the Airwaves

By Thomas W. Hazlett

Top-down regulatory approaches to the allocation of the broadcast spectrum have proceeded more or less undisturbed in this country for 69 years. It's still the Radio Act of 1927 that defines the process whereby radio and television stations gain permission to broadcast. Our current process for allocating broadcast licenses illustrates virtually all of the foibles of government industrial policy—from the persistent bias in favor of industry incumbents, to a penchant for picking losing companies and technologies. But things may be about to change.

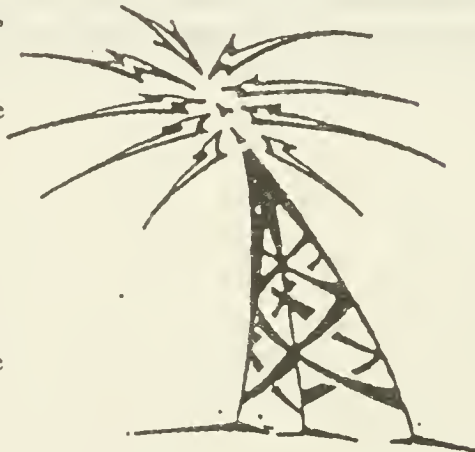
For a great debate now rages in Washington, DC over the granting of licenses to broadcast High Definition Television (HDTV). Do not be ashamed if you feel out of the loop on this one. America's broadcasters, interested to the tune of about \$35 billion, would be happy to have the public leave all questions of radio spectrum allocation to their Washington lobbyists and a few regulators and politicians. But there are some aspects of the Federal Communications Commission's process

for assigning TV licenses that may be worth tuning in for—particularly now that Senate Majority leader Robert Dole has threatened to kill any telecommunications reform unless Congress auctions off the licenses for next-generation TV instead of just giving them away.

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The *sine qua non* of broadcasting today is the free, government-issued license, a windfall tendered to those worthy souls whose behavior is deemed in the "public interest." For decades, this has led to cozy deals between broadcasters and the government. But two new factors today open the possibility of change. One is that reform-minded Republicans, now in control of Congress, are on the prowl for deficit-reducing cash. The other is the recent groundbreaking use of auctions to award licenses to sellers of "personal communications services," which brought \$9 billion into the U.S. Treasury via competitive bidding. A golden opportunity to reverse a lifetime of inefficient radio spectrum policy—including some regulations that have seriously compromised the First Amendment—may now be at hand.

Neither of the major telecommunications bills passed by the two houses of Congress in 1995 grabbed the opportunity to change the way spectrum is allocated, however. Though free-marketeers and Naderite "public interest" groups were both screaming



"giveaway," the plan was simply to fork over new HDTV licenses to the current broadcasters. Only at the 11th hour and 59th minute—after the conference committee had announced a final bill and the Clinton administration had agreed to sign it—did Senator Dole enter the picture and threaten to break up the deal.

Dole's stated objection was the unseemliness of handing big media companies something worth billions of dollars in a time of budget austerity. "Corporate welfare" he called it. The deeper problem for consumers, however, is not that the Federal regulators would hand over too much but rather that they would hand over far too little. The proposed HDTV license confine broadcasters to just the technology and business opportunities envisioned today by Washington. The greatest benefit of auctioning rather than giving out broadcast licenses would be to end stultifying central planning in wireless communications.

Before any new wireless technology or service may be offered to the public these days it must first gain explicit permission from the Federal Communications

Commission. The applicant, if successful, is allowed to offer only a specific product via a given delivery system. The FCC license is merely a pass to use certain types of transmitting equipment. Allocations of the various bands of the radio spectrum continue to be micromanaged by the regulators. A broadcast station is barred from using its license to offer cellular telephone service, and vice versa, though there is no technical bar to doing this.

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The only reliable method for discovering better, consumer-pleasing services is to experiment in the marketplace. But with the FCC in control of the radio spectrum this is impossible. An AM radio broadcaster is, for instance, prohibited from converting to higher-quality digital

transmissions without a formal FCC rule-making. At a minimum, that would consume several years and oodles of lawyers and money. Attorneys rather than economic competitors end up scrimmaging, and it's Commissioners, not consumers, who referee.

The bureaucratic inertia of the Commission is buttressed by the private interests of the licensees, who don't want any competition that could lower profitability. Today's regulatory playing field has been designed, lobbied for, and protected by vested interests precisely because it levies a disproportionately large burden on newcomers. Upstart rivals are dealt with harshly by the administrative process.

Policing the Nation's airways ought to be a low maintenance task that no more requires bureaucrats to plan each detail than road traffic requires government direction. But because government's allocations of spectrum are manipulated by insiders to limit competition, the Commission ends up enforcing cartels instead of policing traffic. This system combines the efficiency of socialist planning with the selfishness of

monopolism. And it is rigidly protective of outmoded technologies and entrenched firms.

The queue of new technology awaiting FCC permission to go on the market is impressive. Proponents of cellular television want to go head-to-head with cable and local telephone monopolies, but have been bottled up in a formal rulemaking since 1992. Digital satellite radio services—offering CD-quality music and news—have been languishing since 1990. “Wireless cable” has been massively handicapped up by the FCC decision to allot only 33 channels to the service—and thwacked by a 10-year lag in getting even these few licenses assigned. Understandably, other potential service providers have just given up: it’s expensive to wait in line. The squandered possibilities are a waste.

There should be no “HDTV license”—that gives the FCC control over the technology, the market, the product. The current HDTV scheme involves an incredible 16-year roll-out. TV stations will be forced to provide simultaneous digital and analog broadcasts until 2008, whereupon everyone have a new digital TV set. Meanwhile we have no idea how much demand

there will be for the somewhat sharper images offered by HDTV. We don’t know if consumers would prefer today’s signal quality if it allowed a wider choice of, say 10 TV signals in the airspace currently set to be allotted to one HDTV channel. No flexibility of this sort is allowed in The Plan cobbled together by the FCC.

When this ambitious scheme flops terribly, wasting billions of dollars and suppressing more valuable media, who will pay? The policymakers who wreaked disaster will be long gone. (Can you name one FCC member who voted to limit America, quite needlessly, to just three national TV networks in the 1950’s, 1960’s, and 1970’s? Or one of the regulators who helped delay cellular telephone service by well over a decade in this country, costing the U.S. economy billions?)

What is needed in spectrum allocation today is a system that allows competitors to provide whatever services consumers demand, and requires them to shoulder the financial risks therein. Sort of like capitalism. The way to open the competitive floodgates in this direction is for the FCC to issue broad, flexible spectrum rights instead of today’s

narrow operating licenses.

Instead of micro-planning HDTV and other uses, the Commission should be allowing firms to provide television signals of the current standard, high definition video, wireless telephone calls, data transfer, or any other service—depending on consumer interest and the costs of supply. The best, quickest, most efficient way to assign such right is via competitive bidding. Auctioning radio spectrum would allow broadcasters to purchase their inputs the good ol’ fashioned way, and resources would travel to wherever they have the greatest consumer value.

This would also permit new technologies to enter the marketplace immediately, without bureaucratic barrier. That would, in turn, stimulate research and development in new services, as profits (rather than legal costs) would immediately accrue to those wireless entrepreneurs who innovatively satisfied consumer interests.

In the process of mightily undercutting government control of the airwaves, auctions would also improve First Amendment protections for

broadcasting. Because of heavy government oversight, electronic speech enjoys far less protection today than print speech (see Tom West's article on page 55). Getting regulators out of wireless

communications will move electronic speech back into the mainstream.

Allowing market forces to assign broadcasting rights will, truly, return freedom to the air.

Thomas Hazlett, a visiting scholar at the American Enterprise Institute, is the former chief economist of the Federal Communications Commission.

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Spectrum Auctions—Only a First Step

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By Thomas Hazlett

The Federal Communication Commission is in the midst of the world's biggest auction, putting up the crown jewels of its wireless license inventory: broadband Personal Communications Services (PCS). These operating permits will allow new competitors to leap into the lucrative field of mobile telephony. This figures to slash prices, improve service offerings and propel wireless into a pitched competitive battle with local telephone monopolies.

There is little doubt that the auction represents a significant advance over the previous methods of awarding spectrum space—comparative hearings and, since 1982, lotteries. The cellular phone lottery attracted so many bids from bogus "telephone" companies that a government warehouse in Pennsylvania collapsed under their weight in the mid-1980's. But the auction—while it is a better method of ensuring that licenses go to the most qualified applicants—does nothing directly to change the underlying problem: The FCC is set up not to enable new competition but to stifle it.

This may spoil the sweet taste of success that auction advocates experienced last year when competitive bidding first became law. Until then, the auction method of allocating FCC licenses, popularized by Nobel laureate Ronald Coase in a 1959 article, had been shunned by official Washington. Rep. John Dingell (D., Mich.) demonized those who called for auctions—including the FCC chairman under President Reagan and Bush—as dangerous ideologues. As recently as 1991, Mr. Dingell had railed against the Bush auction proposal as, "the same old hackneyed approach . . . carried forward by a bunch of unthinking dunderheads in the Office of Management and Budget."

Auctions finally became law last year only because White House concessions and the expected auction revenues—\$8 billion to \$15 billion—outweighed the cost Democratic congressmen would have to pay; depoliticizing license assignments.

But while auctions can distribute license in a relatively low-cost manner, they do nothing to distribute spectrum more efficiently. The Federal Government still micromanages markets, protecting the interest of incumbent licenses and dolling

out entry rights to new players only after years of frustration and struggle.

Take the case of cellular telephony, first demonstrated as technical reality . . . in 1946. The FCC leapt into action, designating a bloc of UHF spectrum to be used for service . . . in 1968. But, believing it may have acted too hastily, the commission reconsidered. It took until 1984 to begin issuing licenses in earnest; the job wasn't finished until . . . 1989.

The cost of this delay was staggering. Economist Robert J. Michaels and I estimated in a 1993 study that expenditures designed to land these licenses—such as applications mills that hired talk-show host Mike Douglas to do TV commercials—cost society between \$500 million and \$1 billion. Yet this pales beside the findings of another study that the 10-year lag in bringing cellular services to market cost consumers and producers \$87 billion. That's a lot of phone calls.

The answer is clearly for the FCC to liberalize spectrum rights. The best support for this policy can be found in a November 1992 study by two FCC staffers, economist Evan Kwerel and engineer John Williams. Their paper laboriously documents an answer to the question: What



if we allowed just one UHF station in Los Angeles to go dark and re-invent itself (in the airspace freed up) as a wireless telephone operator? Having noted that licenses for UHF television in L.A. brought less than \$6 million per megahertz, while cellular telephone licenses were selling for \$70 million to \$160 million, the authors found that the airwaves allotted to UHF could best be used to provide cellular service. Messrs. Kwerel and Williams concluded that this could produce nearly \$1 billion in this market alone.

But the notion that marketplace competition assign spectrum to its highest valued use is simply too explosive. The Kwerel-Williams recommendation of "voluntary [spectrum] reallocation" was quietly shelved, and while the FCC (to its credit) has inched toward liberalization by defining PCS licenses broadly, it continues to act as

a top-down manager of spectrum.

The question is: How much longer can this anti-competitive policy be preserved? The consumers' best hope is that auctions will lead policymakers in Congress, the White House and the FCC to lose interest in protecting incumbent spectrum-holders from future competition. They've already gotten their money—why not move on and sell some more?

But a dangerous counter-effect from the auction is already evident: Lawmakers such as Rep. Ed Murkey (D., Mass.) and Vice President Al Gore are salivating at the prospect of targeting auction reversies for such pet projects as children's programming and hooking up classrooms to the "information superhighway." The political logic of this position may push regulators to boost auction receipts by restricting the use of spectrum.

In fact, this strategy has already crept into the policy debate. Rep. Billy Tauzin (D., La.) has introduced laudable legislation to give broadcasters flexibility to use their new high-definition TV bands for other services such as data transfer. Rep. Rick Boucher (D., Va.) opposed the Tauzin

proposal because, as reported in a trade journal, he feared that it "amounted to a net increase in spectrum supply . . . and would reduce demand for the FCC auctions, costing the government money".

The "Ouch!" you hear is that of the American teleconsumer getting thwacked. True, auction proceeds will be higher if we short-circuit competition. But taxpayers and consumers will eventually lose far more because limiting spectrum shuts off vast sources of dynamic economic activity. If that is, in fact, the ultimate consequence of the continuing PCS auction, it won't be remembered as the free-market milestone it could have been. Instead it will only reinforce the anti-competitive forces hunkered down around the FCC for six decades.

Mr. Hazlett teaches economics and public policy at the University of California, Davis. He served as chief economist of the Federal Communications Commission in 1991-92.

Chairman DOMENICI. I was chuckling because your concept of broader band and more flexibility kind of reminded me of the current debate about block grants. Maybe you do not get that. It sort of seemed funny to us up here. Did you get it, Senator?

Senator CONRAD. Yes, I did.

Chairman DOMENICI. It means you have not been following this block grant argument up here, right?

Senator EXON, you did not get to make an opening statement.

Senator EXON. May I make a brief opening statement?

Chairman DOMENICI. Yes; I think we ought to do that right now. We are going to try to get out of here by noon, if that is all right with you, Senator, and you. We will each get 15 minutes or so.

Senator EXON. Let me start out by commenting on the matter that I think far too much has been made of the fact that we are going to balance a budget on the back of the spectrum auction. We are not going to balance the budget on the back of the spectrum auction, even if we multiply it by three or four or five or ten times the amount we are arguing about here.

Many of us have played very important roles in fashioning budgets. I must say that the reason this has become a road to nowhere is the fact that we have so much time coming up with role models, that we will balance a budget in this fashion. Every effort that I have made in that regard, and every effort that anyone else has made, be they Democrats or Republicans, has always come up short.

When we come up short, then we always go to some magic formula. In this case, the spectrum option has been what every one applies. If I am short of balancing the budget by the year 2002, then I invent some other scheme or means. That is why the spec-

trum option, which started out in the \$6 to \$7 billion range with regard to revenue, jumps up to \$30 and \$40 billion.

The cart should not be driving the horse here, but unfortunately, the legitimate discussion of what we do to bring about fair and reasonable revenues to the Federal Government rather than giving away frequencies has become part of the budget problem rather than part of the solution.

Briefly, let me say, and I would ask that my whole statement be printed in the record, Mr. Chairman, there have been many watershed moments in the history of television and I suggest this is probably one of the most very important ones.

We are about to embark on a new one, digital high-definition television. This new television system presents a whole new set of opportunities for viewers and responsibilities for broadcasters and government. It is my hope to strike a sensible balance between all of them. Therefore, I congratulate the expert testimony that we have had from our witnesses this morning. Nowhere do we see the need for balance more than in the proposed spectrum auction and when we hold it.

As we make the transition to advanced television, the industry will initially have to broadcast in both current analog signals and the new digital ones. There is a broad consensus that when people finally switch to digital, the analog spectrum will revert back to the Government. That seems to be the only thing that we agree on at the present time.

The Government will then auction it off, and for literally billions of dollars, and I simply am not convinced as a budgeteer that regardless of what that billion is, whether it is \$7 billion or \$50 billion, that it is going to have that much difference in the end because I think we are talking about never-never-land and the varying degrees of interest that have been discussed by various members of our panel this morning.

Some see the spectrum option as a cash cow for deficit reduction. I do not, and I do not think that should be the driving force by what we do.

There are proposals such as the one by Senator McCain which would charge the broadcasters up front for the new digital spectrum that was once promised free. Some also want to move up the auction date for the analog spectrum from around 2005 to 2002. Although I am always looking for new budget savings, I am nevertheless concerned about the impact of the timing on the ordinary citizens and the free service that they still rely on to a large extent, especially in the rural areas.

Some argue that hastening the auction or charging for the spectrum up front would simultaneously sound the death knell for free broadcasting television. I think that is a real serious problem, especially with regard to the testimony we received from the people in the center of the room down there, including my constituent from Nebraska.

It may be difficult for many Americans already feeling a squeeze in their own economy to buy the new equipment, whether it be new television or converters.

Let me say that I appreciate very much especially the excellent testimony from my colleague from Nebraska. I simply say that the

more that I hear, the more I see, and the more I learn, it seems to me that we have responsibility on the Budget Committee, and also the Commerce Committee on which I serve, both have to be up front on this matter. I suggest that we are going to have to take a more in-depth look at not only the timing in general but probably different times in different places in the United States, because, as has been said by more than one witness this morning, what may be good and proper and doable in New York City is not possible and doable in Ravenna, NE.

I thank the chair and I thank our witnesses. I will have questions further on down the line.

Chairman DOMENICI. Thank you very much.

I might say the bill that was taken to the President that came out of conference on a balanced budget had about \$15 billion as the total receipts and we did not expect them all to vest in the year 2002. In fact, many of them occurred in 2001. Some even occurred before that.

It is perhaps a coincidence, but essentially the Administration, and Mr. Irving, I might just tell you a little history. You probably know a different version than I. When the President finally had to submit a balanced budget, a new approach was taken to the auction and all of the proceeds from it were going to occur in the year 2002. It is most interesting, the first version was \$28 billion, \$13 billion of which would occur in the year 2002, that is the new part, and then it turned out that budget was \$4 billion short as you looked at it, so that fee turned out to be a total of \$32 instead of \$28 billion within the period of a couple of weeks. That extra \$4 billion brought it into balance.

Frankly, I think we are all somewhat concerned about budget numbers driving specific dates for this very, very serious event in the use of the ban across America, whether it is the digital, whether it is the radio, whichever. Obviously, it is going to make some money for the Federal Government.

You have helped me immensely. Mr. Hazlett, your idea that maybe we ought to consider leaving what companies now own, letting them keep them, seems to me to be something that helps with some of the problems I am hearing and certainly with reference to some of the ideas about hurting the poor. It would still be the marketplace would determine to what extent the current spectrum was used by the particular broadcasters. I understand that.

I have also understood a little better that the transition could very well leave an awful lot of people unable to pay and they would be left out and I think we had better be very concerned about that.

Mr. Irving, I want to ask a question about that, that people would be unable to make the transition cost-wise. When Chief of Staff Panetta met with us in December, it was suggested that the Administration's proposal would provide a "voucher" for television converter boxes. What was the cost of this to the Government and is this still part of the proposal?

Mr. IRVING. There has been some discussion within the Administration about some type of a rebate to consumers, those few consumers that might not be able to afford a converter box or otherwise have cable or telephone company provision of multi-channels.

We believe that the cost is going to be \$20 to \$50, and if I can spend a second as to how we get to that figure.

Anybody who goes out today and buys an RCA or a Sony or soon-to-be Toshiba or Uniden or any other company, Phillips DBS with an 18-inch dish for about \$500 today is buying the dish and they are also buying a receiver-tuner. That receiver-tuner converts a digital signal, because the satellite, the Hughes satellite, the USSB satellite up in the sky today provides a digital signal and then it converts it into an analog signal.

By the end of this year, you will be able to buy the satellite dish and the converter box for \$400, down from about \$900 when they first were introduced. The price is going to go down by more than half in a little bit over 2 years. That is with two million units being sold.

When you start getting into the tens of millions or hundreds of millions of units, you are going to drive that price down even further. And remember, you have both the satellite dish and the tuner, so the tuner is only about half of the cost of that. It is \$200, roughly, retail today, and when you start ramping it up to the tens of millions of hundreds of millions per unit, it is going to drive that price down even further.

So we think it is \$20 to \$50, not hundreds of dollars, for a converter. If that is the case, we are talking about a relatively few Americans who would need that. We believe that the cost is something between \$25 to \$250 million. If you go all the way out and figure that ten million different households will need some assistance, it is \$250 million.

We would expect that broadcasters could help with paying that rebate, but we are working on whether or not that—we are discussing that within the Administration. We are not at this point definitively proposing that. But we are not talking about billions of dollars. We are not talking about significant hundreds of millions of dollars. We are talking about a relatively low cost for a few Americans.

Chairman DOMENICI. Let me just tell you my version, and then I will ask Mr. Burgess if he would like to comment on that. My version of it is that the Federal Government ought to get out of that business, or never get in that business rather than get started now. I cannot imagine the Federal Government getting involved in setting standards for who will get this voucher and who will not and then the Government regulating it after that. From my standpoint, we ought to just do this thing slower and let the market adjust rather than get into that business.

What do you think about this cost of \$20 to \$50?

Mr. BURGESS. Mr. Chairman, I had not heard anything that low. I could talk to the MSTV people, but our best estimate is once it is in full production, you are looking at \$150 to \$200. The reason is that the satellite dish technology, the digital technology for the satellite coming into the home as analog is an analog signal, goes up digital, comes down digital, goes to analog.

We are talking about HDTV, high-definition television, a completely different terrestrial system which will need a completely different kind of box design. The initial cost, they are saying, is going to be \$500, and if it comes down by half within 5 years, you

are still looking at \$250. So I do not believe that you are going to get down to a \$20 cost on the conversion to digital. I think it is going to be much more expensive because it is a different system than the digital systems that are there.

Chairman DOMENICI. Would anybody else like to comment on that? Let us do it in order. Our friend from Nebraska, then you, Mr. Hausman.

Mr. SHRIER. Thank you, Mr. Chairman. I guess as you look out on the horizon, you see this wonderful new technology suddenly available. It is called high-definition television, bright theater-quality pictures, CD-quality sound. What I hear Mr. Irving saying is that for those who cannot afford what is the ability to make that transition to digital or high-definition, let us give them the old technology. They do not make any difference. It is no big deal. But just those that can afford it will, of course, have available to them this special quality new technology.

Go back a little ways to the old 78 record. It went to, I think, a 45, then it was 33 $\frac{1}{3}$, then it was an eight-track tape, cassettes. Boy, that was the most special thing I had ever seen in my life, and all of a sudden here comes CD. It replaced it all. That is kind of what high-definition television will do. The bottom line in our discussion is that it should be available to everybody and it should be free. Thank you.

Chairman DOMENICI. Mr. Hausman?

Mr. HAUSMAN. I think, as you can see, there is a fair amount of disagreement and I think that we would expect that disagreement to exist because there is a lot of uncertainty. The Administration comes up with one number. The broadcasters come up with another number.

This is why I think Professor Hazlett and myself both as economists say the market should be allowed to decide. We should not be sitting here, whether it is somebody in the White House, somebody at the FCC, trying to outguess a market because we do not really have a good idea of what is going to happen.

Let me just comment on this whole voucher idea. The biggest single roadblock to competitive telecommunications in this country with respect to both local and long-distance service has been the systems of subsidy that have been built into the Telecommunications Act of 1934. It took Congress 10 years, if not longer, to finally pass what I consider to be a splendid change, the Telecommunications Act of 1996. But the bad news for me, as someone who has taught this for my whole academic career, you have not ended the problems because we still have the subsidies built in which are still going to be fought over for the foreseeable future and we have to get rid of those subsidies before we can have true competition.

I think to start off with television and set up another system of subsidies is just asking for trouble for the future, because again, as we start to have increasing competition, someone is going to have to pay for these subsidies and it is going to just bedevil the whole competitive transition, just as it has in telecommunications. So I would not think this is a good place to start a new subsidy program for the Congress.

Chairman DOMENICI. I want to move on and make sure Senator Exon and the other Senators who want to ask questions get a chance. I want to make one last observation and then if anybody would quickly comment, that would be fine.

It seems to me that the other thing I have heard here today is that it is very hard to predict both what is going to happen and also hard to predict what should happen. As I see it, some of you are saying this is such a flexible tool for the future which will either on its own or will turn loose much more room for energizing this system with innovation.

I am wondering if we ought to move a bit slower with reference to getting rid of the entire asset and at least having more flexibility built in as we understand how the transition occurs to the utilization of these new available resources. Am I hearing that from anybody? Is anybody saying that, or did I get it wrong? Go ahead, Mr. Hazlett.

Mr. HAZLETT. If it does not embarrass the Senator, I think I agree with you.

Chairman DOMENICI. I do not know enough about you to wonder whether that is all right or not.

Mr. HAZLETT. That is very good, then. [Laughter.]

Maybe this is more than you wanted to know, but as somebody who actually does own an eight-track stereo, I have to testify that technology changes. Some of us are left out in these little cul-de-sacs on the information superhighway or elsewhere. The fact is that we should not suppress the new technologies because of these particular problems. We should try to answer those particular problems as directly as possible.

In this particular instance, the current licensees are providing analog service. People like it. A lot of people subscribe to it, subscribe or watch it. A lot of advertisers like it. Go ahead and vest the current licensees on their current allocations and let them provide that service. If you want to make that inflexible, which I would not recommend, but if you are worried about this promise is going to be taken away, then guarantee that they have to get that service for some period of time or develop some other subsidy program that gives people digital converters so that the broadcasters can deliver some of their product.

But the fact is, these vast new technologies that are out there and so important may make all these discussions about digital converter boxes absolutely moot because we will have interconnections with computers and this stuff about a digital transmission to the television will look very odd. There are advocates out there, a little more futuristic or guru-istic than I might be, but who believe that the television is obsolete in the next generation and that the computer technology is going to be there.

But we have this fabulous new resource. I just do not see that we should screw up the new generation by continuing to work off the 1952 television allocation. At the very best, we are going to get back 130 to 150 megahertz. If everything goes as planned, which it never has before, and the regulatory system spits out this 150 megahertz, we are still only going to use up about 200 or 230 megahertz at the most of the 400 megahertz band. Half of it will

be wasted and Internet access and all these new services will not be there.

Chairman DOMENICI. Senator Exon?

Senator EXON. I believe the Senator from North Dakota would be next.

Chairman DOMENICI. Senator Conrad?

Senator CONRAD. I thank the Chairman and I thank our ranking member, Senator Exon.

First of all, as I hear the testimony from the broadcasters, the Dole-McCain proposal for the auctioning of the second channel is cost prohibitive for you as broadcasters and would threaten the existence of free television. Is that a fair summation of your testimony? I would ask first Mr. Burgess and then Mr. Shrier.

Mr. BURGESS. Senator Conrad, yes, we believe that that is a fair estimation. The only way that you are going to receive significant revenues from the digital channel is if you use that digital channel for something other than free television. Television now reaches 98 percent of the United States. I do not know where I am going to get new viewers. I get paid by the ratings and the advertising revenue is how many people are watching. It does not matter whether half of them are on digital and half of them are on analog. Until we go all digital, there are no additional revenues on this.

Senator CONRAD. You are not going to be able to expand your audience. You are not going to be able to expand, I assume, your advertising revenue. You are not going to get any built-in increases because of this change in technology.

Mr. BURGESS. That is correct. That is correct. HDTV, the High-Definition Television System that we have been talking about, uses the entire six megahertz of the band. There is no multiplexing right now. There is no six channels coming out. And to auction off the spectrum and then say, even if the technology was available that you have to provide people one slim segment of the spectrum for free television, they are getting the same thing that we are giving them now. We are not making an improvement. We are not moving forward.

Senator CONRAD. All right. Mr. Shrier, I just would ask you the same question. With respect to the Dole-McCain proposal to auction the second channel, that would threaten your existence as I hear you say it.

Mr. SHRIER. Senator Conrad, that is an accurate assessment. Rather than duplicate Mike's comments, let me offer maybe a different perspective.

There was a comment earlier that there could conceivably be six program streams. The fact of the matter is, there could be eight and there could be 12 on this new digital signal. But the reality of it is, how in the world are you going to program them? I do not know that there is enough digital-types of programming available. It is certainly not available today. Is it going to be available in the future? Chances are slim and none. But let me add—

Senator CONRAD. You would be covering a lot more Congressional hearings.

Mr. SHRIER. What a wonderful idea.

Senator CONRAD. It is riveting stuff.

Chairman DOMENICI. Senator, if we have hearings like this, they will cover it. Do not worry. [Laughter.]

Mr. SHRIER. I guess the point being that for Howard Shrier to decide to offer my viewers 12 program streams, I trust my neighbors and competitors would do the same thing. In effect, what we would be doing is just splitting the revenue pie, and bottom line, you cannot support the cost of the programming knowing full well that there is not going to be any additional revenue to speak of.

Senator CONRAD. Let me just say that at least for me, I think I have heard enough with respect to what Senators Dole and McCain have been proposing on this auction of the second channel. I have heard loud and clear from my broadcasters, and I obviously represent one of the most rural States in the Nation, and they just tell me very clearly there is no way they could afford to stay in business if that were done. So to me, that is a non-starter.

That raises the question of the speeding up of the auction. We have heard here today a real difference with respect to what the cost to the consumer would be, and I would very much like to use my brief time remaining to try to clarify on that question and to find out if there are other alternatives.

I would first ask Mr. Irving, Mr. Shrier heard something in your statement I did not hear, but perhaps you wanted to respond. I think you were seeking recognition to do that.

Mr. IRVING. Yes; there was a statement made that we do not care about the poor. This is let them eat whatever and not have television. That is patently unfair.

Under the FCC's existing proposal, we are going to have a give-back in 15 years. There are still going to be people in America in 15 years that are not going to have new television sets, that \$20 to \$50 would create some problem for. We are at 94 percent telephone penetration in this Nation. We have 2 percent of our Nation who does not have television service today. We have 65 percent at cable.

To say that we do not care is just totally untrue and unfair to us. What we would like to do is try to find some mechanism to get every American access to this new digital age, but the question is, how do you do that, and we would love to work with the broadcasting industry to figure it out. It is in their economic interest to have—there is an externality. I am not an economist, I am a lawyer, which may be worse. But there is an externality. There is a benefit to broadcast so that every person that wants access to that programming to have access.

How do we do that? In 15 years, we are going to have some people who are not there. In 10 years, we are going to have some people who are not there. And do you know what the reality is? When they turn that digital switch on, there are going to be millions of Americans who can afford to get the \$1,500 set who will go out and buy the \$1,500 set and they are going to encourage that.

So it is not like we are saying everyone should not have it. We are trying to find a way to get there.

Senator CONRAD. Let me ask this question. The Administration has proposed this speeding up of the auction. You believe it will not cost consumers very much because they can get a digital converter box for \$20—

Mr. IRVING. Twenty to \$50.

Senator CONRAD[continuing]. Twenty dollars to \$50. There is a dispute, I think it is fair to say, very clearly here, with respect to what that cost is. Others think it may be \$200 or \$300. That is something we can try to sort out.

But let me ask you this question. Is there a way to speed up the auction but not reduce the time of transition?

Mr. IRVING. That is harder. Could I suggest something else?

Senator CONRAD. All right.

Mr. IRVING. What might be possible, and something the Administration would love to talk to this committee and other committees in Congress with relevant jurisdiction about is, is there a phase-in possibility? Would it be possible to enlarge a market?

I mean, I do not think you have the same problem, with apology to some of our friends in the back, I do not know that GE/NBC or Westinghouse/CBS or Capital Cities/ABC or World Corps/FOX in New York, Los Angeles, Chicago are going to have the same problems converting to digital that maybe some smaller broadcasters might have. And if you look at the way new technologies roll out, they often roll out faster in larger communities and then migrate into rural communities. So maybe there is a way we can talk about how we do the give-back in the year 2005 in the larger markets first and then have a rolling approach.

The reality also is, I think my friends from CBO and OMB would both agree, that you are not going to get the same dollar value for auctions from some of these smaller markets you will from the larger markets. If you take care of the large market problem first, you can solve some of the concerns of—I worked for a Texas Congressman for many years. I am very familiar with the problems of rural broadcasters and want to help solve them. But I also think it would be a tragedy for this Nation if we did not get that spectrum in the hands of entrepreneurs as rapidly as possible and drive some new technologies out.

Senator CONRAD. Let me ask you another question, Mr. Irving, because it has been suggested to me that the Government controls other spectrum that might be made available for auction, that the Government is holding onto too much spectrum and that there is other spectrum that is in our control that we could make available for auction for other of these technologies that none of us may be able to anticipate today, along the lines of Mr. Hazlett. Even though he went to UCLA and I went to Stanford, I still think he may have a good idea here.

Mr. IRVING. As another Stanford person, I am not sure I agree with Mr. Hazlett.

The Government does have access to spectrum. We have exclusive use, however, to only 1.4 percent of the spectrum. The rest of it, we share or industry has exclusive use to.

This Congress, this committee asked us to give 200 megahertz in 1993. We came back with 235. We gave you 17½ percent more than you asked for. You have asked us for another 20 megahertz. We are going to do that, too. Again, we have to take it from Justice, we have to take it from the Department of Defense, we have to take it from the FAA.

But when we move Government users, that is not cost-free to the taxpayer, either, because they have to go out and buy new equipment and they have to write off their investment. We have hundreds of millions of dollars invested by the Defense Department, the Justice Department, the Treasury Department in their existing radios. If we are going to move them, we have to buy them new equipment. The taxpayer pays for that.

We are moving spectrum and becoming more efficient in our use of spectrum every day at the Federal Government and I would be delighted to come back and brief the committee on that. I am briefing the House Commerce Committee on exactly that issue today at 3:30.

Senator CONRAD. Thank you.

Chairman DOMENICI. Senator, in the underlying numbers that almost everybody has accepted at or about \$15 billion, that excess that is sitting around, 20 megahertz of it is proposed to be sold in that. That may not be enough in terms of your question, but there is that recognition that already exists.

Mr. IRVING. May I make one other point? You asked the FCC to come up with 100 megahertz of under-utilized spectrum. If they cannot meet that 100 megahertz, they are then directed to come to NTIA and me to find additional spectrum above the 235 we have given and the 20 we are committed to giving.

Chairman DOMENICI. Senator Exon?

Senator EXON. Mr. Chairman, I just have one question because it has been a very informative hearing and most of what I had intended to ask has already been asked. But as usual, we are going to have to come to some kind of a compromise on all this. I hope that you sitting at that table recognize that whenever you compromise, you do not always come up with what everybody wants but the best that is available under the circumstances.

I am wondering if you could just briefly comment about some type of a compromise. Could, for example, CBO—I am sure you do not have it now—could CBO score an option which combines the President's date-certain digital conversion with maybe a threshold test—I am just searching for words—a threshold test for market share conversion? Is such a possibility good or bad?

For example, the conversion date could be set for, let us say, 2005, unless more than 20 percent of the households in a given area or market are unable to receive digital television. When the markets reach the threshold, then the analog spectrum would be returned for auction.

Mr. MOORE. We could certainly attempt to score such a proposal, Senator. I can tell you that the receipts would be less than the \$11 billion we currently estimate, but we would be happy to confer with your staff about how such a proposal might be crafted.

Senator EXON. Once again I emphasize, while I want to get all the money we can legitimately out of this, I do not want to foreclose free television and you have to have a trade-off there. In other words, the amount of money is important but not the only driving force. Does anybody wish to comment on that?

Mr. BURGESS. Senator Exon, from the broadcasters' standpoint, that makes a tremendous amount of sense for us. We broadcasters are unlike cable. We cannot get by on a two share sign-on to sign-

off. We need the penetration that we have now. My cumulative is 85 or 86 percent of all of the people in New Mexico watch my television station for 5 minutes each week, and if I do not have that 80-percent-plus, we are in trouble in making this conversion.

Senator EXON. Mr. Shrier?

Mr. SHRIER. Senator Exon, there is seemingly something we are overlooking. We have kind of focused in on concerns about the consumer, and I commend that. For whatever it is worth, we are just in the process now of constructing a new television station in Sioux City, IA, about 80 miles north of Omaha, and we are anxious to move forward. In our efforts to secure steel to build a 2,000-foot stick, we were advised that the wait would be minimally 8 months, possibly ten. That is before we even receive the steel. We figure another 3 or 4 months for construction. There are fully three companies in the country that construct towers.

I kind of give you that background because in reviewing the country, there are 50–70 percent of the stations out there that to make the conversion to digital and basically have two antennas on a tower, analog and digital, they will have to construct a new tower. Prospects for getting that done with only three companies that do it and a general shortage of steel are not likely.

So aside from whatever the auction dates might be, aside from whatever the give-back dates might be, I think you have to be realistic to understand, when can this technology be available, and I do not know that anyone really knows at this point when the bulk of the country or the greatest part of the country will have it available. Thank you.

Mr. IRVING. May I respond to that point just very briefly? I have two points. One, when a construction permit is granted to a broadcaster anywhere in the country, they have 18 months under the law to construct under that permit. You are not going to have an open-ended period of time. I do not know why advanced television should be different.

Second, if there are only three people in our country right now who are doing what broadcasters need to be done, under our market-based approach, as this goes out over the airwaves, I am willing to bet that some entrepreneurs are out there saying, if I can find the steel, I can do this business, too. It does not require an engineering degree from the University of Nebraska or Stanford or UCLA to actually build and construct a transmission tower, and if there are only three, the market should take care of that and we should get five or ten as thousands of these new towers are built to satisfy that demand.

I try to be a market-oriented person in my job. I would hope that the market would take care. If there is not an adequate supply right now, sooner or later people will say, there is an opportunity. I can make money. Let me go out here and help my friend, Mr. Shrier.

Senator EXON. I thank the chair. I have no further questions.

Again, I emphasize to all of you as you sit down there in your little cocoon, compromise is the only way this is ever going to be worked out, and I have not seen any of you rush to say that is a great idea. That is what is going to happen and I think we want

your input and advice as to how we pursue that, rather than going into your cocoons, is what is best for you individually.

Mr. Chairman, thank you very much.

Chairman DOMENICI. Let me say, Senator Exon, there are a lot of suggestions besides the one you put forth, although yours is admirable. It just would seem to me that I would not expect them to be instantly responding to whether that is a good solution.

Senator EXON. I did not say, Mr. Chairman, mine was the only solution.

Chairman DOMENICI. Or a compromise, even.

Senator EXON. You are the best known compromiser.

Chairman DOMENICI. I get some things done.

Senator EXON. Once in a while.

Chairman DOMENICI. Thank you very much. [Laughter.]

Senator EXON. Not as much as we used to when we were in control, but—[Laughter.]

Chairman DOMENICI. You cannot do that when you have a President that vetoes everything.

Anyway, what I would like to say for the record, because I got a note here, Senator Exon, that the so-called Dole-McCain bill does not exist, that there is a McCain bill that has been introduced and Senator Dole is not a sponsor of it. He has requested hearings on it and other matters, but to refer to it as an existing bill, I merely would like to say that the majority leader's staff has asked me to say there is no such bill.

Having said that, let me close this up by saying I think we probably have all, and when I say probably all, I am going to include the White House and the President, I think we have all permitted this spectrum fee sale to be driven by the year 2002 more than it should be and I think that kind of encapsulates some of the concerns about needing more time, about having more flexibility. Frankly, I think we had better be careful trying to move that based on the balanced budget date.

But I would also say, from the standpoint of the bill that went to the President that had \$15 billion in, we had projected out the following 3 years after the 7 years and we did remain in balance. So while one-shot asset sales do not solve a budget, when added to everything else, it did kind of trend in the right direction. We just did not plug it in and say, next year we will be \$20 billion in the red. That did not happen, Mr. Hausman. You suggested that might be the case. If you want to look at our budget, we will show you that.

Thank you all very much. We stand adjourned.

[Whereupon, at 12:00 p.m., the committee was adjourned.]

PREPARED STATEMENT OF SENATOR OLYMPIA J. SNOWE

Thank you, Mr. Chairman. As Congress and the President continue to address the issue of balancing the budget, any option that can quickly garner billions of dollars is certain to generate immediate interest. Although I believe that one-time revenue raisers—such as asset sales—are no way to go about changing the long-term growth in the deficit that is caused by irresponsible and unchecked spending, they certainly can play a significant role in reducing the deficit for a specific year.

The President's last offer on the budget indicated to what great lengths some will go to utilize asset sales to reach a specific budget target in a specific year: Not only did President Clinton endorse a highly-questionable auction proposal in the year 2002—not coincidentally the same year we have all targeted for achieving balance—

but he also chose to ignore CBO's scoring for that auction and increased its value by \$11 billion to meet this goal!

Therefore, because of their revenue potential, the attention that has been focused on spectrum auctions comes as no surprise. I think we would all agree that the spectrum is a valuable public resource—and I think we would all agree that if recent auction history is any indication, future spectrum auctions can contribute a significant amount toward deficit reduction.

However, I strongly believe that the issue of spectrum auctions cannot and should not be addressed simply in terms of money. Rather, the issue of spectrum auctions should be addressed in terms of policy. Because spectrum is a scarce and quantifiable resource, it should be distributed and utilized in a manner that best serves the population at large.

While auctions could clearly allow for the distribution of this resource in a manner that would put it to its "highest and best use," these auctions must be structured in a manner that ensures the resource is properly managed. I believe it is in the best interest of everyone—consumers, spectrum users, businesses, and the government—that the approach we take to spectrum distribution ultimately ensures that spectrum is used in a manner that best serves the population at large. Auctions clearly accomplish this goal—but that does not mean auctions will *always* accomplish this goal.

Given that there is a limited supply of available spectrum and an almost limitless demand for its use, Congress needs to think carefully about the types of auctions it implements and the impact of these auctions on the Spectrum Management System. As the number of spectrum users increases, the amount of spectrum available for new and existing services decreases. Thus, to plan successfully for tomorrow's use, we must have a clear understanding of expected future spectrum requirements and spectrum availability, as well as the potential effects of new technology on the efficient use of spectrum.

I believe today's hearing will provide us with an excellent opportunity to study the economic and budgetary impact of the various spectrum auction proposals that have been discussed in Congress and the White House—and believe it will ultimately highlight the importance of efficient and proper spectrum management. For as with all of our natural resources—be they minerals, timber, oil and gas, or fisheries—it is essential that we focus on the impact of our decisions not only in budgetary terms, but also in terms of broader policy implications. I therefore, believe it is imperative that our focus on "policy" never be blurred "money."

Thank you, Mr. Chairman. I look forward to the testimony of this morning's witnesses.

PREPARED STATEMENT OF SENATOR BARBARA BOXER

Mr. Chairman, thank you for calling a hearing today on uses of the spectrum. I hope the hearing will shed some light on this complex and technical issue and I look forward to the testimony of our distinguished panel of witnesses.

Television, Mr. Chairman, is an incredibly powerful and influential medium. I don't think anyone here will dispute that. As we debate proposals to auction off spectrum, we may be determining the fate of who receives television programming and at what cost.

As I understand it, the main issue we are confronted with regarding the auction of radiofrequency spectrum is not whether or not it will happen, but when.

As we proceed, I want to be sure we keep in mind the consumers who will be affected by the decisions we make regarding the spectrum.

As things currently stand, there are two main proposals on the table. The first is to conduct an "up-front" auction of the spectrum now designated for broadcasters' transition to advanced television. I do not support this approach. My primary concern is that it will negatively impact the availability of free over-the-air television for consumers. I also do not believe in dramatically changing the rules in midstream for the transition to digital television.

The Administration's proposal would instead loan spectrum to the broadcasters for their transition to advanced television, but require return of the spectrum currently being used for analog channels by the year 2005. The spectrum to be returned would be auctioned in the year 2002. In my opinion, this is a more prudent approach. I am interested in hearing, however, whether this will be enough time for the average consumer to purchase a new, more technologically advanced television.

If it is not, we need to consider the repercussions. A premature return of spectrum could leave many consumers—primarily the lower-income and the elderly—stuck

with obsolete television sets and no free broadcast programming. Television is often the critical connection to the outside world for many of these Americans.

Over 30 percent of the country relies solely on free over-the-air television for their news, information and entertainment.

And judging from the constituents' response to skyrocketing cable rates back in 1992, I can only imagine the kind of response we would get if many consumers lost their free channels entirely.

I understand that the FCC had a plan to allow the analog spectrum to remain with the broadcasters for 15 years instead of 9, as proposed by the Administration. I am interested in hearing from the witnesses whether it best serves consumers to go with 9 years or 15 years.

In conclusion, Mr. Chairman, I look forward to hearing from our distinguished witnesses on this very compelling issue.

Thank you.

THE PRESIDENT'S FISCAL YEAR 1997 BUDGET

WEDNESDAY, MARCH 20, 1996

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:15 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Grassley, Nickles, Lott, Brown, Gregg, Snowe, Abraham, Frist, Exon, Lautenberg, Simon, Conrad, Dodd, Sarbanes, Boxer, and Murray.

Staff present: G. William Hoagland, staff director; and Anne Miller, director of budget review.

For the minority: William G. Dauster, democratic chief of staff and chief counsel; and Sue Nelson, director of budget review and analysis, senior analyst of medicare.

OPENING STATEMENT OF CHAIRMAN DOMENICI

Chairman DOMENICI. Senators, I am going to try something a little different unless you violently object. I am going to ask the OMB Director to testify right now, and then we will give our comments and remarks after we have heard her testimony.

Senator GREGG. And questions?

Chairman DOMENICI. And questions, whichever we want. We have time for questions and opening statements, but I thought we would just try it this way and see how it works getting the statement out.

Dr. Rivlin, as you came up here, I shook hands with you and I thanked you for all the time you spent in this branch of government, the branch that you are in, and part of that Congressional Budget Office, which is a very good institution, that you had something to do with. And I said this is probably the last time we will welcome you to our committee. I am sure that you know there is a great deal of respect for you here, and many of us are very willing to trust what we have seen in you in that next body that you are going to be part of, and many of us are going to support you. But we will miss you with reference to the astuteness you have given to your job and the many good ideas you have promoted since you have been there. We happen to disagree again this year on the budget, but we welcome you.

We will make your statement part of the record, and could you summarize in, let's say, 15 minutes?

**STATEMENT OF ALICE M. RIVLIN, DIRECTOR, OFFICE OF
MANAGEMENT AND BUDGET**

Dr. RIVLIN. Yes, I could, Mr. Chairman. I appreciate your kind remarks, and I have enjoyed working with you and with this committee from different vantage points over a very long time. And now I am going to a new part of the Government, the Federal Reserve, that some people don't consider part of the Government. I am looking forward to that but I will miss this committee.

Let me summarize my statement very briefly, if I may. I am happy to be back here to present the President's budget for fiscal 1997. I hope we can wrap up fiscal 1996 without having another Government shutdown, and get on to fiscal 1997. The passage of the Senate bill, which restores some of the funding for 1996 that we were interested in—especially for education and the environment, is a step toward resolving the 1996 budget. We need to work together, on a fast track, to get a spending bill that Congress can pass and the President can sign.

I hope the President's fiscal 1997 budget can serve as the basis for a bipartisan effort to pass a 1997 budget that will give us appropriations before October 1 and not subject us to another long wrangle like we had this year, and put the budget firmly on the track to balance.

The congressional leadership, as you know, is meeting with the President today, and we regard this as a window of opportunity for working together to balance the budget.

Three words describe the President's budget: balance, reform, and investment. The Clinton administration, as you know, is building on its very strong deficit reduction record. The deficit was \$290 billion in fiscal 1992, the year that had just ended when the President took office. It was \$164 billion in fiscal 1995, the year that ended last September 30. That is a lot of progress.

We estimate the deficit for the current fiscal year will be \$146 billion. That estimate assumes we will be successful in restoring the \$8 billion in budget authority for education, the environment and technology. But if the fiscal 1996 deficit turns out to be \$146 billion, the President will have fulfilled his campaign promise to cut the deficit in half in 4 years.

With respect to the deficit as a percentage of the total economy, or GDP, we have already cut it in half, from 4.9 percent in 1992 to 2.3 percent in 1995, and the current projections would take that number under 2 percent.

This budget lays out a plan for finishing the job, balancing the budget by 2002. We believe our plan would balance using the economic and other assumptions of the Congressional Budget Office (CBO). And we have worked hard to make sure that is true. We have obtained informal CBO scoring of various parts of our budget proposal and, in some cases, we have changed the wording or the substance of the proposal to ensure CBO scoring.

So we are reasonably confident that, when CBO looks at this budget as a whole, they will find that it reaches balance in 2002. But, to be absolutely sure it reaches balance under CBO scoring, we put in an insurance policy. CBO will most likely produce a new set of assumptions about the economy. They haven't done that since December, so they are likely to come out with new assump-

tions before they score this budget. We don't expect their assumptions to change much, but if CBO, in using its new assumptions, finds that our budget does not reach balance in 2002, we propose cutting additional discretionary spending to close the gap. We would lower the discretionary caps in 2002, or 2001 and 2002—whatever it takes to reach balance. So our budget will balance in 2002 under CBO numbers, no matter what CBO does.

Having a budget that balances in 7 years using CBO numbers was very important to many Members of Congress. Indeed, I have a quote from last December from one of my favorite Senators. It says,

You will find, Mr. President, you will find that we have only one goal in mind. Everything else is on the table, Mr. President, but not the one thing that is sacred to our commitment, and that is a balanced budget in 7 years using the Congressional Budget Office.

The quote is from Chairman Domenici, December 15, 1995, and I am happy to say we have done it with this budget.

The Office of Management and Budget and the rest of the Administration's economic team is actually slightly more optimistic about the economic outlook than CBO. And we are not shy about saying so, because, in the last 3 years, the economy has actually performed better and the deficit has come down faster than either CBO or OMB predicted.

Under OMB assumptions, this budget would reach balance in 2001, and run a considerable surplus in 2002. If that surplus, or fiscal dividend, as we call it, materializes, we propose using it to (a) extend the President's proposed tax cuts for the last 2 years, and (b) to reduce the cuts in discretionary spending.

This budget doesn't just get to balance, although that is an important feature. It gets to balance the right way: by reforming entitlement programs and investing in the future. About half of the savings in this budget come from mandatory or entitlement programs. We do not gut medicare or medicaid or welfare, but we do propose reforms that will make those programs work better and cost less as we move toward the next century.

For medicare, we are proposing reforms that would save \$124 billion over 7 years while strengthening medicare. Our budget extends the solvency of the Hospital Trust Fund for another 10 years. It gives seniors more choices among private health plans, and mounts a vigorous attack on fraud and abuse in medicare. It reduces the rate of growth of provider payments, but it holds the Part B premium at 25 percent of cost.

For medicaid, we are proposing reforms that give the States much more flexibility. States could, for example, move the medicaid population into managed care without a waiver. We are proposing limits on the growth of per capita spending within the Medicaid Program, but the President's proposal preserves the medicaid guarantee for the most vulnerable Americans who need health insurance, and ensures that money continues to flow to States that have the most needy people.

With respect to welfare reform, the President has made a major commitment to reform welfare as we know it. The President's proposal makes assistance time-limited and conditional on work. But it protects children, and it provides more funds for child care.

The budget doesn't cut everywhere. It invests in the future. We believe the overall objective of economic policy is to raise the living standards of average Americans. Reducing the budget deficit contributes to that end, as do investments in education, training, technology, and the environment.

This budget continues the President's emphasis on education. For example, it expands the Head Start Program, which would reach 800,000 children in 1997 and be on track to reaching a million by 2002.

The budget also continues help for dislocated workers, those buffeted by change in the economy, by helping them to acquire new skills and new jobs. The budget would assist twice as many workers as were helped in 1993.

We have put a major emphasis on restoring the environment, and I will mention only one program because we have worked very hard on it in the last few months, and that is the program to restore Florida's Everglades, a great national resource that is very much in danger.

This budget contains reform and investment on both on the spending side and the tax side, but the main point is we can balance the budget. The President has a plan to do that, and he wants to work with the congressional leadership, and with all the Members of Congress, to get that done.

Thank you very much.

[The prepared statement of Dr. Rivlin follows:]

TESTIMONY OF
ALICE M. RIVLIN
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
COMMITTEE ON THE BUDGET
UNITED STATES SENATE

March 20, 1996

Mr. Chairman, Members of the Committee, I am pleased to be with you today to discuss the President's budget for fiscal 1997.

This budget:

- reaches balance in 2002, while
- reforming entitlement programs and
- continuing to invest in the future.

The budget reaches balance the right way, by making government more efficient and cutting lower priority spending. It is designed to make further progress on the central goal of this Administration -- to promote a strong economy and, with it, higher average living standards now and in the future.

This budget reaches balance in seven years, using either the Administration's economic and technical assumptions or the latest assumptions from the Congressional Budget Office.

If I have a single point to make today, it is this: The President is committed to putting the budget firmly on a track to balance this year -- not after the political season, not after the November elections, but now.

We should not let this opportunity pass us by. Over the last several months, the President worked closely with the bipartisan congressional leadership to reach an agreement on balancing the budget over seven years. He spent over 50 hours with the leaders in serious, productive negotiations. They came much closer together.

In fact, the two sides have close to \$700 billion in savings in common -- savings in entitlements and discretionary programs, savings in Medicare and Medicaid, and savings in welfare and other programs. Those savings would not only balance the budget, but also pay for a modest tax cut for average Americans and small businesses. The budget embodies those common savings.

The congressional leadership wants bigger tax cuts, offset by deeper cuts in Medicare and Medicaid, other mandatory programs that help farmers and the poor, and discretionary spending. But the President believes those cuts are too deep and would threaten the Government's vital role in guaranteeing health care to vulnerable Americans and investing in the future. He has proposed that the two sides quickly enact the savings they have in common and give the American people a balanced budget.

Three Years of Progress

Upon assuming office over three years ago, this Administration faced two problems.

- First, we had an economy stuck in low gear. Although it had emerged from recession almost two years earlier, growth was slow. In fact, the unemployment rate at the beginning of 1993 was a quarter-point higher than when the recession ended. Investment was slow, limiting growth in future productivity and living standards.
- Second, we inherited a huge budget deficit. It had risen from a then-record \$74 billion in 1980 to \$290 billion in 1992. As a share of the Nation's Gross Domestic Product (GDP), the deficit was at levels that it had previously reached only in recessions. The 1980-92 deficits, in turn, quadrupled the national debt in just 12 years. And perhaps most ominously, the debt grew much faster than the economy. From 1981 to 1993, the ratio of national debt to GDP almost doubled.

The size of the budget deficit and the weakness of the economy were not unrelated. As long as the Federal Government would claim so much of the Nation's supply of credit, interest rates would remain high, and investment would remain correspondingly low. Without greater investment, growth would remain sluggish in the short run, and productivity and incomes would be limited in the long run.

Facing such serious challenges, the President stepped up to the plate. Despite concerns about the near-term economic and political implications, the President put the long-run interests of the nation first and proposed a serious deficit reduction plan.

Skeptics reacted strongly. Many predicted that the economy would plunge into recession, that employment would shrink, and that the deficit actually would rise, rather than fall. They were wrong:

- The economy has performed better than even we had projected. Strong economic growth means higher incomes and greater prosperity.

- Real median family income rose in 1994 (the last year for which data are available) compared to 1992, the year before the President took office. The rise was the first since 1989. The poverty rate also fell for the first time in five years.
- Since January 1993, real average hourly earnings are up by 0.6 percent — reversing a trend of falling wages through the 1980s.
- During the 1992 campaign, then-Governor Clinton promised eight million new jobs in four years. Last month, with the President in office just over three years, job growth hit 8.4 million. Moreover, this increase in employment has been solid.
 - Almost 93 percent of the new jobs are in the private sector.
 - More than half of the jobs are in the high-paying managerial and professional occupational categories.
 - After falling for the preceding 12 years, manufacturing employment is up in this Administration.
 - The new jobs are full-time jobs. While total employment is up by 8.4 million under this Administration, part-time employment among those who say they would prefer to work full time but cannot find full-time jobs has fallen by 1.45 million.
- Even though the economy continues to grow, interest rates are down — partly because the President addressed the deficit problem. On the day the President took office, the 30-year Treasury bond yield stood at 7.32 percent. It has fallen below 6 percent at times in the last three years and now stands below 7 percent.
- Investment has boomed under this President. Inflation-adjusted investment in producers' durable equipment has grown at double-digit rates — two-and-a-half times faster than from 1981 to 1988. That increase, which reflects the private sector's confidence in America's economic future, is the best proof that the President's policies are good for business, investment, and capital formation.
 - Stock market investors believe in prospects for this economy as well; stock prices are up over 60 percent in three years.
- Even in a growing, high-employment economy, inflation remains low. Under most measures, inflation has remained below 3 percent a year — even with unemployment under 6 percent since mid-1994.

- Finally, and partly because of these other economic achievements, we have cut the budget deficit. In dollar terms, it has already fallen almost in half, from \$290 billion in 1992 to \$164 billion in 1995. As a share of the economy, it has fallen by more than half — from 4.7 percent to 2.3 percent.

- We have cut the deficit for three straight years for the first time since Harry Truman was President. We are on track for a fourth straight year of deficit reduction in 1996, and we are proposing additional reduction for 1997 — producing five straight years of deficit reduction for the first time since before the Civil War.

- In every year of this Presidency, the deficit has come in lower than the Administration projected at the beginning of the year. Put simply, our deficit reduction program has performed better than even we projected.

- The Nation's debt is no longer growing faster than its income. After almost doubling from 26.5 percent to 51.9 percent from 1981 to 1993, the ratio of national debt to the GDP has reversed course, falling to 51.4 percent in 1995.

And yet, while the economy and budget are moving in the right direction, we still have work to do: Wages and family incomes have begun to rise, but families still find it hard to make ends meet. Even with millions more new jobs, many hard-working Americans still feel insecure in the jobs they have. We need to complete the job that the President began three years ago: We need to balance the budget and invest in the education and skills of the American people.

The President's budget has five main goals:

1. Reaching Balance in Seven Years

Under OMB's assumptions and estimates, the budget reaches balance in 2001. CBO's scoring is more cautious. We estimate that using CBO's last available assumptions and estimates, the President's budget reaches balance in 2002. With so much focus on CBO scoring, we have taken extraordinary steps to ensure that the budget reaches balance in 2002 according to CBO (even though, half-way through fiscal 1996, this is now more a six-year plan to reach balance than a seven-year plan).

- First, if the deficit in 2000 is not well below CBO's projections, the tax cuts end. At that point, those who want to maintain the tax cuts would have to comply with the "pay-as-you-go" rules and find a way to pay for them.

To date, the President's budget policies have cut the deficit much more than the Administration or CBO has projected. We believe that this budget also will exceed CBO's estimates for deficit reduction, thus leaving the tax cuts in place.

On the other hand, if deficit reduction is proceeding well ahead of CBO's estimate, a "trigger" provides for (1) continuing the tax cuts, (2) adding to discretionary spending after the year 2000, and (3) splitting any additional savings among more tax cuts, more discretionary spending, and more deficit reduction.

- Second, the budget includes a mechanism to ensure balance in the face of changing CBO economic and technical assumptions. CBO plans to update its assumptions in March or April, and these assumptions could change the President's path to balance; in 2002, they could produce a bigger surplus or a deficit. In the event that CBO estimates a deficit in 2002, the budget calls for an automatic reduction in the discretionary spending limits, or "caps," to reach balance.

As you can see, the President has gone the extra mile to keep his commitment to reaching balance in seven years, as scored by CBO. We hope this satisfies those in Congress who have said that their most important goal was a seven-year, CBO-scored balanced budget.

2. Controlling Spending

The President's economic program of 1993 was designed to generate \$505 billion of deficit reduction over five years, with more than half (\$255 billion) coming through lower spending. In fact, we now estimate that the five-year plan, plus the economic improvements that the plan helped to bring about, will generate \$796 billion in deficit reduction.

It is spending constraint, more than increased revenues, that put deficit reduction ahead of schedule. In fiscal 1994 and 1995, over 60 percent of the deficit reduction above what we had originally expected has come because spending was lower than projected; less than 40 percent has come from greater-than-expected revenues.

In 1995, Federal outlays equaled 21.7 percent of GDP -- the lowest ratio since 1979. In both 1994 and 1995, spending was a smaller share of GDP than in any year under the previous two Administrations.

Furthermore, since 1992, Federal spending has grown at an annual rate of 3.2 percent per year -- less than half the rate of growth in 1988-92 (6.7 percent) or 1980-88 (7.6 percent). In "real" (inflation-adjusted) terms, the disparity is even more striking. Real spending since 1992 has grown only 0.8 percent a year -- less than a third the rate of 1988-92 (2.5 percent) or 1980-88 (2.7 percent).

The President's 1997 budget continues to control spending. The President proposes about \$630 billion of spending cuts (measured with CBO scoring) over the seven-year period, 1996-2002.

Discretionary spending. About \$297 billion of the savings will come in this category. Discretionary spending is already at its lowest share of GDP since at least 1962. In inflation-adjusted dollars, discretionary spending in 2002 would reach its lowest level since 1979.

Through its proposals for discretionary spending, the budget funds a Government that is leaner, but not meaner, one that works efficiently, manages resources wisely, focuses on results rather than merely spending money, and provides better service to the American people. Through the National Performance Review, led by Vice President Gore, we are making real progress in creating a Government that "works better and costs less."

We have cut the size of the Federal workforce by over 200,000 people, creating the smallest Federal workforce in 30 years and the smallest as a share of the total workforce since before the New Deal. We are ahead of schedule to cut the workforce by 272,900 positions, as required by the 1994 Federal Workforce Restructuring Act that the President signed into law.

Just as important, the Government is working better. Such agencies as the Social Security Administration, the Customs Service, and the Veterans Affairs Department are providing much better service to their customers. Across the Government, agencies are using information technology to deliver services more efficiently to more people.

We are continuing to reduce the burden of Federal regulation, ensuring that our rules serve a purpose and do not unduly burden businesses or taxpayers. We are eliminating 16,000 pages of regulations across Government, and agencies are improving their rule-making processes.

In addition, we continue to overhaul Federal procurement so that the Government can buy better products at cheaper prices from the private sector. No longer does the Government pay outrageous prices for hammers, ashtrays, and other small items that it can now buy more cheaply at local stores.

As we look ahead, we plan to work more closely with States and localities, with businesses and individuals, and with Federal workers to focus our efforts on improving services for the American people. Under the Vice President's leadership, agencies are setting higher and higher standards for delivering faster and better service.

Entitlements. Another \$277 billion of spending cuts comes in this category, building on this Administration's impressive record of restraint. Since 1992, entitlement spending has grown less than half as fast as in 1988-92 (2.4 percent a year, compared to 5 percent) -- despite today's larger and faster-growing elderly and retired population.

The budget brings much-needed reforms to the major entitlements -- including Medicare, Medicaid, and welfare -- while protecting the elderly, working families, children, and other vulnerable Americans.

Medicare: The budget strengthens and improves Medicare, extending the solvency of the Part A Hospital Insurance trust fund through the next decade. It gives older Americans and people with disabilities more choices among private health plans, makes Medicare more efficient and responsive to beneficiary needs, attacks fraud and abuse through programs praised by law enforcement officials, slows the growth rate of provider payments, and holds the Part B Supplementary Medical Insurance premium at 25 percent of program costs; it imposes no new cost increases on beneficiaries.

The budget reforms payment methods for hospitals, doctors, managed care facilities, and other providers; enhances access to, and the quality of, health care in rural areas; expands and improves Medicare managed care; and expands coverage of preventive benefits.

Medicaid: The budget reforms Medicaid to give States unprecedented flexibility to manage their programs while preserving the guarantee of health coverage for the most vulnerable Americans. Millions of children, pregnant women, people with disabilities, and the elderly would retain the guarantee of basic health and long-term care services.

The budget imposes a per-person limit on spending, and cuts Disproportionate Share Hospital (DSH) payments and retargets them to hospitals that serve large numbers of Medicaid and uninsured patients. It provides special payments to States for their transition into the new system, and for meeting their most pressing needs. It gives States significant new flexibility to administer their programs more efficiently. And it retains current nursing home quality standards and enforcement, and continues to protect the spouses of nursing home residents from impoverishment.

In addition, the budget proposes premium subsidies to help those who lose their jobs pay for private coverage for up to six months.

Welfare: Welfare reform is mainly about work. The President's plan would repeal Aid to Families with Dependent Children (AFDC) and create a new, time-limited, conditional entitlement for cash assistance. As soon as they join the rolls, beneficiaries would have to develop and sign a personal responsibility contract with their welfare office. Within two years, able-bodied parents would have to work or lose their benefits. And after five years, they would no longer get cash benefits.

The budget builds upon the steps that the President has already taken to fix specific parts of the welfare system. In 1994, the Federal Government collected a record \$10 billion in child support. A year later, the President signed an Executive Order to make the Federal Government a model employer for collecting child support. In July 1995, the President ordered that Federal regulations be strengthened to prevent welfare recipients who refuse to work from getting higher Food Stamp benefits when their welfare checks are cut. And, over the last three years, the Administration has given 37 States the freedom to test ways to move people from welfare to work and protect children.

3. Investing in the Future

Like the President's previous budgets, this budget proposes steps to help Americans build a brighter future for themselves and their families. It maintains the President's investments in education and training, science and technology, environmental protection, and other priorities. And it maintains a strong defense and provides the resources to conduct an effective foreign policy.

Education and Training: Today's most successful workers are those with technical skills and a firm educational footing who continue to learn throughout their careers in order to compete successfully in this fast-changing economy.

The budget maintains and expands the President's investments in Head Start, Goals 2000, Charter Schools, Title I - Education for the Disadvantaged, Safe and Drug-Free Schools and Communities, and Pell Grants. It proposes an income tax deduction of up to \$10,000 to help middle-income families pay for postsecondary education and training expenses. And it proposes a series of new initiatives.

Because technology can expand learning opportunities for all students and help raise student achievement, the President is proposing a "Technology Literacy Challenge Fund," with four goals: helping States put enough computers in every classroom; connecting these computers to the Information Superhighway; giving teachers the training they need to integrate technology into teaching; and fostering the development of high quality, widely available educational software.

The President also proposes to create an achievement-based scholarship program, rewarding the best and the brightest of high school students. This program would grant \$1,000 honors awards to the top five percent of graduating students in every secondary school in the Nation, making clear the Government's commitment to excellence for all children.

The Environment: Americans want a government that helps protect the environment and our natural resources without burdening business, choking innovation, or wasting taxpayer dollars. To meet these objectives, the Administration has been reinventing the regulatory process to cut excessive regulation, and targeting investments in programs that will have the biggest impact on improving the environment, protecting public health, providing more opportunities for outdoor recreation, and enhancing natural resources. While continuing to maintain environmental enforcement and protect national parks and other sensitive resources, the President proposes new initiatives to address specific environmental challenges.

The President proposes to offer a targeted tax incentive to clean up "brownfields" -- older, contaminated industrial sites in distressed urban and rural communities. This incentive would spur the private sector to create jobs, return land to productive use, and clean up the environment in our communities.

The President also proposes an "Everglades Restoration Fund" to provide a steady source of funding mainly for land acquisition to maintain the South Florida Ecosystem -- a unique national treasure that includes the Everglades, Florida Bay, and other internationally-renowned natural resources. The budget proposes \$100 million a year for four years to establish the Fund. It also proposes a 1-cent-per-pound marketing assessment on Florida sugar production, which would add about \$35 million a year to the Fund.

Science and Technology (S&T): Technological innovation has accounted for at least half of the nation's productivity growth in the last 50 years. Technology has become a major engine of economic growth, a significant contributor to our national security, a generator of new knowledge, and a critical tool in protecting our health and environment.

The budget maintains vital investments in S&T by adding funds for basic research in health sciences at the National Institutes of Health, for basic research and education at the National Science Foundation, for research at other agencies that depend on S&T for their missions, and for cooperative projects with industry and universities.

The budget maintains the President's commitment to biomedical and behavioral research, which promotes the health and well-being of all Americans. For the National Institutes of Health, the budget includes increases for HIV/AIDS-related research, research into breast cancer and other health concerns of women, minority health initiatives, high performance computing, prevention research, gene therapy, and developmental and reproductive biology.

Also with regard to AIDS, the budget proposes increased funding for the Ryan White CARE Act for grants to cities disproportionately affected by the HIV epidemic; to States to provide medical and support services; to community-based organizations to provide HIV early intervention services; and to support pediatric AIDS demonstration activities. The President also has sought more funds for State AIDS drug assistance programs funded under Title II of the Ryan White program -- to finance newly-discovered life-prolonging AIDS therapies, some of which are beginning to receive FDA approval.

American Leadership: The budget provides the resources to support U.S. diplomatic leadership in defending our interests and promoting democracy, free markets, and peace throughout the world. It also proposes to continue sustaining and modernizing the world's strongest, best-trained, best-equipped, and most ready military force.

On the diplomatic side, the budget proposes to increase funding for international security assistance to support the peace process in the Middle East (including partial financing of a squadron of F-16 aircraft for Jordan), to further the move toward free markets and democracy in Central Europe and the New Independent States through programs such as the President's Partnership for Peace initiative, and to continue to support the peace process in the Balkans.

To promote an open trading system, the budget puts a high priority on programs that help U.S. exporters meet foreign competition and seize the opportunities that trade agreements offer. It proposes to address the new transnational threats to U.S. and global security and prosperity; to better meet our commitments to international organizations; to increase voluntary contributions to a variety of international organizations principally involved in development, population, and environmental programs; and to continue providing humanitarian and disaster relief.

For defense, the budget continues the Administration's policy of the last three years -- sustaining and modernizing the world's strongest and most ready military force, capable of prevailing with our regional allies in two nearly simultaneous regional conflicts. This budget maintains our commitment to high levels of training and readiness for that force and equipping it with technology second to none.

The President continues to strongly back programs that support military readiness, directly or indirectly. Our armed forces have been extremely successful in attracting and retaining motivated, high-quality personnel, in part due to the President's continuing strong commitment to adequately fund service members' quality of life programs. For example, the budget provides military personnel a 3 percent military pay raise, effective January 1997, and increased funding to upgrade and improve military barracks and family housing.

4. Cutting Taxes for Average Americans and Small Business

The President believes we can balance the budget and, at the same time, provide modest tax relief for middle-income Americans and small businesses. Because resources are scarce, we must put them where we need them most. Thus, the President has proposed tax-cut initiatives that focus on the highest family and national priorities, and that will help families and small businesses to help themselves.

Child tax credit. To help moderate-income working families with children, the budget phases in a \$500 tax credit for dependent children. The full credit is available for families with incomes under \$60,000, and the credit is phased out at incomes of \$75,000. The credit will apply before the earned income tax credit, thus giving these moderate-income families even more help.

Tuition deduction. The budget phases in a \$10,000 tax deduction for education and training expenses, including college tuition. It will be available whether or not the taxpayer itemizes deductions, and is phased out between \$100,000 and \$125,000 of income. It will provide relief from the heavy burdens of college and mid-career training costs, and should encourage especially those families who may be most deterred by the up-front cost of trying to send their first family members to college.

Individual Retirement Accounts. The budget expands the availability of Individual Retirement Accounts (IRAs) by doubling, over time, the income limits. It allows families to make penalty-free withdrawals for educational, housing, and medical needs. It establishes new back-loaded IRAs for those eligible for regular deductible IRAs. These provisions will encourage families to save for their own retirements and for other contingencies, so that they can contribute to their own economic security.

Small business incentives. The budget increases, from \$17,500 to \$25,000, the amount of investment eligible for expensing, thus reaching the level that the President originally proposed in 1993. It also provides targeted relief from estate taxation for small businesses and family-owned farms.

Pension simplification. Building on bipartisan efforts in the Congress, the President proposes to simplify rules (and expand coverage) for pension plans sponsored by businesses of all sizes, nonprofit organizations, and State and local governments, as well as for multiemployer plans. The budget includes a new, simple retirement savings plan (the National Employee Savings Trust, or NEST) for small businesses that combines the most attractive features of the IRA and the 401(k) plan, minimizes administrative and compliance costs, and eliminates the need for employer involvement with the Government.

Urban and environmental initiatives. The President proposes to expand the number of enterprise zones (EZs) and enterprise communities (ECs), and to liberalize the tax treatment of expenses for environmental remediation of contaminated sites ("brownfields") in low-income areas.

To finance these initiatives and help reach balance, the budget saves \$59 billion over seven years by cutting corporate tax subsidies, closing loopholes, and improving tax compliance. For example, the budget prevents corporations from achieving tax arbitrage by deducting interest on borrowings against life insurance policies on their employees, or where the corporation owns tax-exempt obligations; addresses recent developments in tax-motivated financial products; curtails manipulation of the tax accounting rules; and tightens rules that are designed to prevent tax avoidance through expatriation and the use of foreign trusts.

The budget improves compliance with, and refines eligibility for, the earned income tax credit (EITC). But it protects the 1993 expansion of the EITC that cut taxes for 15 million working Americans. We must not raise taxes on low- and moderate-income working families with children to pay for tax cuts for the most well-off.

5. Completing the Task

I will conclude my testimony where I began: The President is committed to reaching an agreement with Congress to balance the budget -- and doing it this year.

We stand at an important moment in the Nation's history. For the first time in memory, we have a President and Congress who agree on the need to balance the budget. We must not waste this opportunity.

12

Senator GRASSLEY [presiding]. The Chairman is going to be gone about 10 more minutes, and what we will do is we will take 5 minutes on each side, and I will go first and then you.

Senator EXON. Are we going to have opening remarks?

Senator GRASSLEY. The Chairman didn't make clear——

Senator EXON. Yes, he did.

Senator NICKLES. I think he wanted them with the questions.

Senator GREGG. I thought it was opening remarks or questions.

Senator SIMON. I think so, too.

Senator EXON. You know, the Chairman isn't here. What I understood him to say was that we were going to let the witness go first. Then we would continue with the opening remarks from the Chairman and the ranking member, then go to the questions. You have a right to do anything you want but I thought that was the understanding.

Senator GRASSLEY. OK.

Senator LAUTENBERG. Let's vote.

Senator EXON. No, don't vote.

Senator GRASSLEY. Senator Domenici's staff said that was Senator Domenici's desire that we would each have 5 minutes for opening statements at this point, and then we will proceed to questioning in 5-minute rounds, the way that people came in.

Senator GREGG. Charles, I would suggest we limit opening remarks to the ranking member and the Chairman when he returns rather than have everybody make opening remark, then get on with questions. If nobody has an objection?

Senator GRASSLEY. I tell you, the committee ought to be run the way Senator Domenici wants it run, and Senator Domenici's staff said that is the way he wanted it done, so that is the way I am going to do it until Senator Domenici comes back and says something differently.

OPENING STATEMENT OF SENATOR GRASSLEY

We were glad to hear your opening remarks, and we very much hope that the President does want a balanced budget and that he does have a scheme to get to a balanced budget. But we remember 12 months ago when the President presented a budget. He didn't want a balanced budget. It wasn't balanced. And it was 6 months after we started talking and proceeding down the road of getting a balanced budget in June of last year that the President finally made his pronouncements that he was for a balanced budget.

He said that he was for a balanced budget through almost all of last year, scored by something other than CBO, or with some sort of refinement by the Administration of CBO's numbers. Finally, at the beginning of this year, the President put something on the table that he called a balanced budget. That is very shortly the President has been for a balanced budget even though he has been talking like he has been for one for a long, long time.

So we have a chance with this budget to see whether or not the President's actions are commensurate with his rhetoric. We won't know that until we get it scored, and we would probably find some games like underestimating inflation and defense as a gimmick to get some more money, or we may see the unrealistic discretionary savings that come in the outyears that make it very, very difficult to balance the budget in such a short period of time, meaning putting off most of the decisions until tomorrow.

In a very real sense, because of the games that can be played with unrealistic discretionary savings coming in the last year, we get a "manana" budget that really puts off the tough decisions until the next century. And I think that it is fair to say that Americans are tired of waiting for a balanced budget. They want tough decisions made today and not to put it off until a later day.

I am particularly concerned that while the Administration is touting its tax cuts—and it does a very good job of that—even the same numbers that Republicans have used, \$500 per child—they fail to mention that there is a big asterisk in this whole tax-cut plan that puts working families at the end of the line if the economy is not performing well after the year 2000 that they won't continue to get their tax cuts.

This kind of puts families at the end of the lines, puts big government at the first of the line. We ought to be thinking in terms of putting an asterisk in the functioning of big government instead of increasing the funding for IRS, like we are doing, to hire 3,000 more agents or more travel dollars for the Secretary of Energy or trips to Disney World for bureaucrats. We ought to have these things dependent upon the economy rather than the tax cuts for the working families.

So it is disappointing to see the Administration has its priorities upside down, that it puts big government ahead of working families.

President Clinton has failed to follow through on his State of the Union pledge as far as this budget is concerned in carrying out the era of big government being over. This budget still keeps the big spending practices that we have had for a long period of time.

So I trust, Mr. Chairman, that we are going to as a committee not let down the American people. We are going to carry out our promises to make sure that not only is the budget balanced, but it is balanced in a way that gives credibility to it by making spending cuts now, not tomorrow.

Chairman DOMENICI. Senator Exon, please go ahead.

OPENING STATEMENT OF SENATOR EXON

Senator EXON. Mr. Chairman, thank you very much. I want to welcome Dr. Rivlin back once again for what probably will be your last appearance before the Budget Committee, at least in your present capacity.

I believe that I speak for all the members on this side in wishing you a very speedy confirmation and all the best in your new post at the Federal Reserve.

Dr. RIVLIN. Thank you, Senator.

Senator EXON. The Fed's gain is our loss, and we will miss your expertise, your honesty, and your good humor that we have known for all these years. I trust that we will have the benefit of your wisdom, Dr. Rivlin, even if it is on an unofficial basis from time to time.

For 18 years, I have worked with you on budget matters, and I have always marveled and appreciated more than you will recognize your common sense, your honesty, and your exceptional talent. Good luck from all of us in your new assignment.

First, I want to commend you and the President for the progress that you have made during the past 3 years to reduce the deficit. Faced with a staggering deficit run up by the previous two Administrations, you measured up to the task. The President has kept his word and cut the deficit nearly in half in 3 years, from \$290 billion in 1992 to \$164 billion in 1995, a significant accomplishment that is oftentimes overlooked.

In fact, the Administration has brought down the deficit for 3 years in a row, for the first time since Harry Truman was "giving them hell" as President of the United States.

The United States now has the lowest deficit—let me repeat that. The United States has now the lowest deficit as a share of the economy of any major industrialized nation in the world. We have more to do, but the record has been one that I think we should be proud of.

According to CBO, even without the President's much needed balanced budget plan, deficits will be \$1.5 trillion lower over the next 7 years than CBO projected prior to the President's historic 1993 deficit reduction plan.

Yesterday, Congress received the President's 1997 budget that treated all of the themes outlined in last month's budget overview. It is now a 7-year balanced budget, as you have emphasized—let me repeat. It is a 7-year balanced budget using CBO assumptions. I am confident that when CBO finally scores this budget, it will be in balance.

The President should be praised for presenting an honest budget. It is not sweetened with the nectar of rosy economic scenarios. There are no budgetary moonbeams casting false hopes. The cuts are real, and the savings are genuine. The budget will be in balance. It is tough medicine.

My free, unsolicited advice to the majority is to tell them that it would be wise to resist the natural political temptation to lambast the President's budget; rather, they should take credit for driving him to it, if that is what they wish to do. I would echo what the Senator from Iowa, my friend Senator Grassley, just said. This budget of the President is very different—and very real—from the President's budget of a year ago, as this Senator took issue with at that time. This is a very real budget. I think it is a good framework regardless of who gets credit for doing what.

I suppose there is not the high drama normally associated with the release of the budget. I barely heard the drum roll, because this budget, in one form or another, has been on the table for many months. It continues the long march to a balanced budget that we began last year. This budget contains many of the common savings to which the President and others, including the Republican leadership, had agreed to. This full budget rivets specific program cuts upon a larger framework of saving.

I continue to question the wisdom of cutting taxes during an effort to balance our budget. It still rings hollow to me. However, I am pleased to see that the Clinton administration is moving in the right direction. The tax cuts in this year's budget are very nearly paid for by closing the loopholes and eliminating the corporate subsidies.

By contrast, the Republican budget included \$230 billion in tax cuts that would have been paid for with cuts in the Medicare and Medicaid Programs and others.

I simply want to say, Chairman, that I appreciated very much the chairman of this committee, Senator Domenici, for his tireless efforts in this regard. And I hope that the budget that you are presenting here today can be used as a framework, in a bipartisan fashion to get on with balancing the budget in 7 years.

Regardless of who is responsible for it, I emphasize in closing one other thing: This is a balanced budget in 7 years or less. It is CBO scoring right down the line. And I like very much those escape valves you have in the end to further tighten, if necessary, or to alleviate the tightening, if possible, if the economy responds as you and others think it will.

I would ask, Mr. Chairman, that the full context of my remarks be put in the record as if delivered. I thank you for your time and courtesy.

[The prepared statement of Senator Exon follows:]

OPENING STATEMENT OF SENATOR JIM EXON

I too want to welcome Dr. Rivlin to what will probably be your last appearance before the Budget Committee in your current capacity as OMB Director. I believe that I speak for all of the Members on our side in wishing you a very speedy confirmation and all of the best in your new post at the Federal Reserve. The Fed's gain is our loss, and we will miss your expertise, honesty, and good humor. I trust that we will have the benefit of your wisdom, Dr. Rivlin, even if it is on an unofficial basis.

First, I want to commend you and the President for the progress you have made during the past 3 years to reduce the deficit. Faced with a staggering deficit run up by the previous two Administrations, you measured up to the task. The President has kept his word and cut the deficit nearly in half in 3 years, from \$290 billion in 1992 to \$164 billion in 1995.

In fact, the Administration has brought down the deficit for 3 years in a row, for the first time since Harry Truman was giving 'em hell as President. The United States now has the lowest deficit as a share of the economy of any major industrialized nation. According to CBO, even without the President's much needed balanced budget plan, deficits will be \$1.5 trillion *lower* over the next 7 years than CBO projected prior to the President's historic 1993 deficit reduction plan.

Yesterday, Congress received the President's 1997 budget submission. It is a full dress treatment of the themes outlined in last month's budget overview. It is a 7 year balanced budget using CBO assumptions. And I am confident that when CBO finally scores this budget, it will achieve balance.

The President should be praised for presenting an honest budget. It is not sweetened with the nectar of rosy economic scenarios. There are no budgetary moonbeams casting false hopes. The cuts are real—the savings are genuine—the budget will balance.

I suppose there is not the high drama normally associated with the release of a budget. I barely heard a drum roll. That is because this budget—in one form or another—has been on the table for many months. It continues the long march to a balanced budget we began last year. This budget contains many of the common savings to which the President and the Republican leadership agreed. This full budget rivets specific program cuts upon the larger framework of savings.

I continue to question the wisdom of cutting taxes in an effort to balance the budget. It does not make any sense. As such, I am pleased to see the Clinton administration is moving in the right direction. The tax cuts in this year's budget are very nearly paid for by closing loopholes and eliminating corporate subsidies. By contrast, the Republican budget included almost \$230 billion in tax cuts that would be paid for with cuts in medicare and other programs.

It takes time to analyze fully such a massive undertaking. There will be specific program cuts with which individual Senators will disagree. I am sure that I will be no exception! But I can say right now that overall, this is a fair budget; it is a consensus budget that steers a middle course.

Last November, my Republican colleagues misread the American people. They saw ripples on the surface and concluded they had a mandate for radical change. But it is clear that they didn't see the deeper current that always pull our great Nation towards midstream.

That is why the American people have rejected out of hand the Republican budget as too radical and too extreme. That is why in poll after poll, the American people say they believe the President is taking a course that reflects their priorities.

So where do we go from here? My friends on the other side say that they want a balanced budget. I know that my good friend, Chairman Domenici, has toiled in the deficit reduction mills and is serious about balancing the budget.

I can't say the same about all of the Republican majority—especially the Lost Boys of the House freshmen class who seem more concerned about ideological purity than a real balanced budget. To them, there is only one way to balance the budget—their way—with their cuts in medicare—with their tax breaks that benefit most the wealthy.

The President has shown us in his budget that there is another way to do it—a fair way that represents mainstream America. I harbor no illusions. This budget is not a be-all or an end-all to the debate over a balanced budget. But it keeps us on the right path and it is up to us to take the next step forward. Let's give those who are serious about balancing the budget the green light. The rest should get out of the way.

Chairman DOMENICI. Thank you very much, Senator Exon.

Senator Gregg, you are next. Might I just take 10 seconds of your time?

Senator GREGG. Mine?

Chairman DOMENICI. In response to my good friend, Senator Exon, who talks about how tough this budget is, I would just remind everyone that there is a very big moonbeam in it: the discretionary accounts of this Government grow 4.4 percent in this budget—4.4 percent while they are touting cuts. And if you look at 7

years, it is amazing, because if they were to keep their priorities all the way through, they would have to cut the rest of discretionary spending 30 percent. I think the 4.4 is an election year budget, and the failure to tell anyone how the 30 percent cut is going to occur is a political budget. It is impossible, for one thing, but I just would like to call that to everyone's attention.

Senator EXON. I would add, Mr. Chairman, if I might, one way to do that would be to eliminate the tax cuts that you are for and eliminate the tax cuts that the President is for.

Chairman DOMENICI. Well, Senator, when you see the budget that has the tax cuts in it, you will find that that has nothing whatsoever to do with medicare, medicaid, or welfare reform. But we will just wait until we put it into the package.

Senator Gregg?

Senator GREGG. Before you returned, the question was whether or not we are doing opening statements or are we doing questions?

Chairman DOMENICI. Whichever you prefer at this point. You can mix it up. We will hope to get back to you again, but we may not.

Senator GREGG. All right. So if we have questions, we had better ask them, right?

Chairman DOMENICI. We might, if everybody is quick.

Senator GREGG. I also wish to congratulate Dr. Rivlin for her appointment to the Federal Reserve, and I know she will do an excellent job there.

I have a couple of general questions. As I look at the numbers, first off, I do want to associate myself with the comments of the ranking member and the Senator from Iowa. I think it is good that the President has brought forward this year a budget that moves to balance on the numbers that he is presenting, you are presenting, as compared with last year when, unfortunately, the budget that was brought forward showed deficits as far as the eye could see. This is a fundamental redirection and one which is positive.

The issue is, of course, when do we reach balance? How do we reach balance? And are the numbers genuine that are being used to approach balance, or are the numbers doable? "Genuine" may be the wrong type of term. Are the numbers doable?

In that context, as I am looking at this, the budget runs through 2002?

Dr. RIVLIN. Yes.

Senator GREGG. For the purpose of getting to balance. As I look at it, it appears to me that you are talking about an overall savings, under your estimates or calculations of savings, of somewhere around \$577 billion in the discretionary/mandatory number. And of those two, approximately 56 percent of the mandatory savings and 58 percent of the discretionary savings fall in the last 2 years of the budget, the year 2001 and the year 2002. Is that correct?

Senator NICKLES. Would you say that again?

Senator GREGG. About 56 percent of discretionary and about 58 percent of mandatory fall in the last 2 years of the budget. Would that be approximately right?

Dr. RIVLIN. That is approximately right, and it is approximately the same breakdown that is in the Republican budget.

Senator GREGG. So we don't know who is going to be President, right? Even if the President is re-elected, that is beyond his term. Right?

Dr. RIVLIN. That is right, and that is true for both our budget and the Republican budget.

Senator GREGG. Now, if we look at the first year of the budget, the savings which are estimated for this year are about \$16 billion and for next year about \$22 billion. Is that correct?

Dr. RIVLIN. I think so. I don't have——

[The following was subsequently supplied for the record by Dr. Rivlin:]

Excluding the tax cut, total policy changes proposed under OMB scoring are \$168 billion in fiscal year 1996 and \$22.8 billion in fiscal year 1997.

Senator GREGG. Mandatory and discretionary. So almost all the heavy lifting is going to occur the final 2 years of the budget, and the way you are going to ensure this, as I understand it, is through this enforcement mechanism, which I don't fully understand, but if I partially understand it, it is that if the savings are not accomplished, then the tax cut is essentially eliminated. Is that right?

Dr. RIVLIN. That is right, if the deficit is still there.

Senator GREGG. Then the tax cut is eliminated.

Dr. RIVLIN. Right.

Senator GREGG. Now, that tax cut goes into place before you get to those numbers, isn't that true, or parts of that tax cut?

Dr. RIVLIN. We assume the tax cut would be enacted in the next year.

Senator GREGG. So as a practical matter, if these targets aren't reached, it is likely that there would be a tax increase to obtain the outyear goal.

Dr. RIVLIN. No, I don't think that is necessary. We don't know what the composition of Congress will be or who will be President at that time. If the deficit, for whatever reason, does not go down as fast as CBO now predicts it will, then Congress will have to figure out what to do. That is no different from the way it is now. When Congress receives new deficit projections, it has to figure out what it is going to do about the deficit. Congress can do something about it on the spending side, or it can do something about it on the tax side.

Senator GREGG. Well, under your mechanism, as I understand it, there would be an automatic elimination of the tax cuts which had already been put in place and we will end up with a tax increase.

I will move to one other item because I see my time is running out, and that is the Medicare Fund. The representation that you are pushing off the date of bankruptcy of the Part A fund to the year 2010, isn't that essentially accomplished by shifting \$60 billion of the home health care costs from Part A to Part B, which means you are basically shifting it from the insured fund on to the general taxpayer?

Dr. RIVLIN. No; we accomplish much of the solvency extension by reducing the rate of growth of provider payments, particularly the hospital update. The bulk of the savings comes from provider payments.

Senator GREGG. But there is a \$60 billion shift, is there not?

Dr. RIVLIN. There is a shift, and we think of it as going back to the way the law originally handled post-hospital home health.

Senator GREGG. Well, the practical implications of that \$60 billion shift is that instead of those payments coming out of the insured fund, which are contributed to as part of the health care premium, they will be coming out of, at least to 68 percent or maybe 75 percent, the general taxpayers because they will be coming out of the general fund?

Dr. RIVLIN. The insured fund is a hospital fund, in our view, and that should be used for hospital-related expenditures.

Senator GREGG. Well, the practical effect is you are taking the money out of the insurance fund—instead of taking it out of the insurance fund, you are taking it out of the general taxpayers; instead of the recipient bearing the burden of that cost, you are basically asking the entire population to bear the burden of that cost.

Dr. RIVLIN. Of part of it.

Senator GREGG. Sixty billion dollars.

Dr. RIVLIN. We think that is where it belongs.

Senator GREGG. I understand your policy. I was just asking the question.

Thank you, Mr. Chairman.

Chairman DOMENICI. Senator, in answering your question about the second round, I think if we all stayed at 5, we will get a second round. I thank you.

Dr. RIVLIN. Was that a question or a statement? In other words, could I respond?

Senator GREGG. It was a combination.

Chairman DOMENICI. If you feel like you should respond, go ahead.

Dr. RIVLIN. Yes, I would like to talk about the outyears and the allegation of back-loading.

Any budget reduction plan will have more of the savings toward the end of the plan, for a couple of reasons. First, if you are cutting the rate of growth of something like medicare or medicaid, which all of us are doing in trying to balance the budget, those savings accumulate and they are bigger at the end of the period—in anybody's plan.

Second, interest savings add up over time, and they accumulate. In both the Republican plan and in our plan, a disproportionate amount of the interest savings are in the last year or the last 2 years.

As we look at the various plans that are on the table, particularly the original Republican plan and the most recent Republican plan, they are all about equally back-loaded. Much of the savings come in the last 2 years. Our plan contains about 62.6 percent of overall savings in the last 2 years; the Republican plan has 61 percent.

I am not saying this is terrific. Maybe one could move some of the savings up front. But it is impossible, if you are cutting rates of growth and accumulating interest savings, not to have more of the overall savings in the latter years than you have in the first year; otherwise, you overachieve. And all of the plans are about equal in this regard.

Senator GRASSLEY [presiding]. Senator Lautenberg?

Senator LAUTENBERG. I think Senator Simon was here ahead of me.

Senator EXON. Well, here we go again, Mr. Chairman. I have been arguing this for 18 years. It is who is here when the gavel sounds, and not who arrived at 2 o'clock in the morning.

Senator LAUTENBERG. Leave it alone. That is mine. [Laughter.]

Thank you very much, Mr. Chairman. I, too, want to join in the commendation given to Dr. Rivlin. We will miss her, not only her pleasant personality and her good humor, but her excellent work and her ability to respond to questions in a forthright and experienced manner. And we wish you well at the Federal Reserve Board.

I listened to, if I may call my friend from Iowa the acting chairman, because that seems to be his post this morning, and I heard the criticism of the President's budget, without acknowledging that there is a significant mission that will be accomplished with this. Rather, it seems that we kick off this game with a political football and immediately start reminding everybody what the President didn't do. So I want to take a couple of moments to remind everybody what the Republicans didn't do. They didn't hold to their word when they promised to gut medicare, when they promised to gut medicaid, when they promised to gut education. They, as we say, chickened out. Now, that has no reference to home products.

The fact of the matter is that, were it up to our friends here to balance the budget, they would have caused a \$100 billion more cut in medicare—call it medicare growth, call it whatever it is, it is the medicare targets. They would have caused an \$80 billion cut in the Medicaid Program. Even though CBO adjusted these numbers in January to make them more realistic, there was still a reduction that they proposed of \$189 billion in programs.

Well, the American people have let their voices be heard—and it was heard even here, surprisingly—that they want investments in education and in the future. When the President's budget is laid out, there are three very important parts: its balance, its reform, and its investment. And anybody who has ever had an honest job knows that if you don't invest in tomorrow, you won't have your job when that period occurs.

America, the greatest country on Earth, refusing to make the investments long term because they don't have a political payoff. It is a disgrace.

And so the President makes an investment. And when he calls on the Republicans on the Senate side and he said, Help us, we need more in education, suddenly there was a melting of the hearts, even though the polls helped, and we got this week over \$2 billion more in aid for education for the remainder of this year, the current fiscal year. We got three-quarters of a billion dollars more in environmental investment, for clean water, for safe drinking water, for Superfund. Suddenly there was a realization that the folks back home don't want to leave their kids a legacy of dirty water, of dirty air, of ground that is not fit for them to play on.

And so as we start off this budget review, I think it would be great if we could start off by looking at the numbers, posing the questions, instead of a political diatribe about what the President didn't do, the President worked darn hard. He has got a product

up there. Present your product, then tell the American people what you are "agin" as well as what you are for.

I don't think that I will ask any questions, Mr. Chairman. Thank you.

Chairman DOMENICI. Senator Abraham?

Senator ABRAHAM. Thank you, Mr. Chairman. I will try to continue in the same bipartisan spirit here. [Laughter.]

First, I just want to pay my compliments as well to Director Rivlin and wish her well in her next responsibility.

I also welcome the President, through this budget, to the debate on the world of balanced budgets. Obviously, a year ago, we were in a slightly different position, and the budget which was initially presented was one which continued substantial deficits. I think that if nothing else, we have made a lot of progress over the last year because we have come to the point where everybody is now talking in the context of balancing the budget.

I hope that this year we can make similar progress as we talk about how we accomplish a balanced budget and move from what I think is sometimes an illusory debate into one in which real, concrete, specific terms are addressed.

So let me just do this—and I do not want to make a lengthy opening statement and will submit some specific things for the record—let me just ask you, Director Rivlin, a couple of questions.

First of all, obviously, this debate about the percentage of the budget which is back-loaded discretionary cuts is one that has already been opened by previous speakers. I do want to set the record straight, though, that the Republican plan that you referenced as having approximately the same amount—I think it was 50 percent of the Republican discretionary cuts occurred in the last 2 years versus over 60 percent in this budget. But it also ought to be noted that the plan that we passed, Mr. Chairman, cut \$220 billion in those areas in the first 5 years, which is almost as much in the first 5 years as the plan being presented today does in 7 years. So it is not as though we shirked any responsibility to move at the beginning in our budget.

My question is has the Administration focused on those very steep reductions in those final 2 years and begun at least thinking about, or are you prepared to offer any sense of where those kinds of reductions would occur?

Dr. RIVLIN. Yes, we are, but only in general terms because the Congress, as you well know, makes those decisions 1 year at a time. The budget doesn't normally lay out a track of discretionary spending, especially non-defense discretionary spending.

But what we have done is to look at the programs that we regard as high priorities. We believe those programs, which invest in the public, in the future of the American economy, or in protecting the environment, should be protected from future cuts. We identified those programs, and said that other Government programs would be cut across the board; in the year 2000, those other programs would be cut by about 20 percent.

That is a very large number, and it means we will have to make severe adjustments in those other programs.

But we think this budget will balance more quickly than CBO does, so we believe there will be a fiscal dividend in the last 2

years. And we would add that dividend back, if it is sufficient, to some of those other discretionary programs that will have absorbed cuts.

Senator ABRAHAM. So you do not have any specific areas in those last 2 years that you think could absorb these very substantial reductions?

Dr. RIVLIN. Nothing more specific identifying the priorities that would not absorb them.

Senator ABRAHAM. You have not tried to identify those?

Dr. RIVLIN. No, nor has anyone else to my knowledge.

Senator ABRAHAM. The second question I have is this. One of the debate here on the Hill has been over adjusting the Consumer Price Index, one of the bipartisan efforts, as you know, here to reach a balanced budget. Was that considered, and if rejected, are there any specific reasons why you have chosen in that to include a significant change in the CPI?

Dr. RIVLIN. We did not propose legislating a change in the CPI. We do agree with most economists that there is an extent to which the CPI probably overstates inflation, or the increase in the cost of living.

The Bureau of Labor Statistics has put out its own reports on adjusting the way the CPI is calculated to reduce the extent of that overstatement of the cost of living, and we have assumed that the CPI will rise less rapidly than it otherwise would because of those corrections. So those corrections are assumed in the baseline.

But we have not asked for a reduction in the CPI by legislation, nor do we think that is advisable.

Senator ABRAHAM. And you would not support it if that were the kind of budget presented?

Dr. RIVLIN. No.

Senator ABRAHAM. Thank you.

Senator GRASSLEY [presiding]. Senator Simon?

Senator SIMON. I thank you, and I want to join everyone else, Dr. Rivlin, in congratulating you—and I know you are going to miss these opening statements that we make.

Dr. RIVLIN. Oh, yes.

Senator SIMON. Just a few observations. Number one, the two things that President Clinton has been criticized most for are the two things that I think he should be proudest of and the American people should be proudest of. One is deficit reduction in the 1993 budget. That reduced interest rates, created jobs, and ought to be something we all look at as a prototype of what we ought to do.

The other area, which is not immediately under consideration here, obviously, is trying to give health care to all Americans. We now have 41 million Americans without health care.

Having said that, let me also say that I am not as harsh in my criticism of this budget as my friends on the other side, but I have concerns.

Number one, the tax cuts do not make any sense whether they are proposed by Republicans or Democrats. When we get to the point where we have surpluses, by all means have tax cuts, but not until then.

Second, I think we ought to be looking—Senator Abraham asked a question about the CPI—I think we ought to be looking at adjust-

ments, and significant adjustments. The group that reported to the Finance Committee said the CPI is exaggerated from .7 percent up to 2 percent. I do not know what is right, but 0.5 percent reduction in the CPI right now would be tough medicine but much better than some of the alternatives outlined in this budget.

When you talk about discretionary cuts over these years of \$297 billion, and only \$16 billion of that coming from defense, frankly, that means cuts in education; that means cuts in health care; that means cuts in other things that I do not think we ought to be cutting.

I think an adjustment in the CPI makes an awful lot more sense. And when I think it was Senator Gregg asked you the question about why the back-loading—let us be honest. The principal reason for back-loading is the political reason, on both sides. That is why handling this with a CPI adjustment soon would make an awful lot more sense.

We are waiting until the end for the tough decisions on both sides. I commend Senator Domenici for proposing right at the beginning of our budget discussions that we balance the budget in 7 years, and I appreciate his leadership on that. But I think the reality is that that is unlikely to happen unless we have the constitutional amendment to force us to do it. And buttressing that, as you look through the figures here, I notice that generally, OMB's calculations are conservative, but when we get down to 10-year Treasury bond rates, blue chip estimates are 1.2 percent higher than OMB's estimates, and my guess is that that is because the people who make these calculations on Wall Street assume we are not going to reach the balanced budget. I think that is the probability. I think we are going through something very similar to Gramm-Rudman in terms of reaching the balance.

Then, one other minor criticism. Our colleague Senator Fritz Hollings is the one who educated me on gross interest and not net interest. I see "net interest" all over here, but I do not see the gross interest figures. And let me say in fairness that every Administration prefers to use net interest because it looks better than gross interest, but we ought to be realistic and have gross interest figures in a document like this.

Anyway, those are my observations, and I have taken my 5 minutes, and I thank you, Mr. Chairman.

Dr. RIVLIN. Might I respond to a couple of those points? When the constitutional amendment was being debated a year or two ago, the Clinton administration said we do not need an amendment, we just need to balance the budget. And I think our record of cutting the budget deficit in half over that period shows that we do not need to amend the constitution, we just need to get this done, and that is still true.

We are now all in favor of balancing the budget in 7 years. We just need to do it.

Senator SIMON. If I may just interject, I am all for doing it. Our history for 29 years is that we are not going to do it, and my guess is that 5 years from now, it will be very apparent that we have not done it, and it will hurt the economy in the process.

I thank you, Mr. Chairman, and I thank you, Dr. Rivlin, and I wish you the best.

Dr. RIVLIN. Thank you, Senator.

Chairman DOMENICI. Thank you, Senator Simon.

Senator Brown, I believe you are next.

Senator BROWN. I would be happy to yield to my colleague from Oklahoma.

Chairman DOMENICI. Fine.

Senator Nickles?

Senator NICKLES. Mr. Chairman, thank you, and I want to thank my colleague from Colorado for switching positions with me.

Dr. Rivlin, welcome.

And I would like to comment on my colleague, Senator Simon, that I hate to see you leave this committee, and one reason is because you did advocate a constitutional amendment to balance the budget, which I happen to think we desperately need.

Mr. Chairman, I want to make a couple of comments and maybe shed a little different light on the record. Dr. Rivlin mentioned that the deficit is half of what it was a few years ago. I want to put something in for the record, and Dr. Rivlin, I will be happy to submit it to you, and if you disagree with one dollar of it, I would be happy to hear your response.

I am looking at the deficit estimates that were made by CBO in January of 1993 compared to where we are today. Actually, in 1993, CBO was estimating a deficit of \$310 billion, and the actual deficit was \$255 billion, and now the deficit is \$164 billion in 1995.

Looking at this table, I see no spending cuts. I see tax and fee increases as 29 percent of the reason for the reduction. I see technical and economic reestimates of 76 percent. And actually, I see spending increases over the baseline—the baseline that started back in 1993.

So according to my figures—and I am going to make two or three statements—I see no spending cuts whatsoever. There are actual spending increases in those 3 years over the baseline, tax and fee increases which were significant—the 1993 tax bill was the largest tax increase in history—but the bulk of the deficit reduction, or 76 percent of the deficit reduction, was through technical and economic reestimates.

Now, here is the crux of the problem as I see it today. You are estimating the deficit away, not really using spending reductions or cuts. The OMB baseline in July of 1995, 9 months ago, for 1996 through 2002, was \$1.553 trillion. In March of 1996, you say it is \$884 billion. Well, you basically cut it in half just by technical reestimates, not by spending changes, not by making reductions in CPI or terminating programs. You have made technical estimate changes. As a matter of fact, the difference in that is \$669 billion from July to March. That is \$669 billion.

In the last month—this is kind of shocking—between your February budget in 1996 and your March budget in 1996, through your technical baseline changes, you saved \$107.9 billion.

My point is that almost all of the deficit reduction that we have had for the last 3 years has been through either tax increases or technical reestimates; and then, in the last 9 months, you have done an unbelievable job of technical reestimates that have basically cut the deficit in half. You go from \$1.5 trillion down to \$884 billion—that is a big change—and in the last month, \$107 billion.

If that rate continues for another 6 months, you will have the budget balanced, and we will not have to do a thing.

I am troubled by that. This is rosy scenario, maybe rosy scenario's sister. Maybe it is a significant improvement from last year. This is the ninth budget we have had from the Administration in the last 13 months. The one that we had 13 months ago had \$200 billion deficits forever—forever—and that was not acceptable. I think this Congress did pull the Administration along, and I think this budget is a significant improvement over where we were 13 months ago.

But still, I see it being almost all reestimates. I do not see it being decisions that say we are going to cut spending, or decisions that we are going to be fiscally responsible.

I look at the outlay charts that you have, and I see outlays rising every, single year. When you are talking about cutting spending, I think you are talking about reducing the rate of growth of government.

And then, for my colleagues who talked about the changes in medicare, both the Administration and the Republican plans were going to spend over the next 7 years \$1.7 trillion. The difference in outlays is minimal—it almost does not show up. The only difference is in Part B. And we were saying that yes, for couples who made over \$150,000, we did not think taxpayers should subsidize them. And I do think you are playing a shell game when you say we should take \$60 billion out of medicare, which is paid for by a payroll tax, and put that over into the Part B fund, three-fourths of which is now paid for by taxpayers. I think that is playing a shell game with numbers and, frankly, is not very responsible.

Dr. RIVLIN. Senator, I am not smart enough to follow all of that, but let me respond to a couple of things. First, looking at the chart, we are not talking estimates here. The deficit reduction record of the last 3 years is history. The deficit came down. The actual deficit for fiscal 1992 was \$290 billion. The actual deficit for fiscal 1995 was \$164 billion, and we cannot be very far off in estimating \$146 billion for fiscal 1996 because the year is half over. The deficit will be somewhere around \$146 billion, and that is half of \$290 billion.

So none of that is an estimating difference. That is real stuff. History has proven that we can reduce the deficit.

Senator NICKLES. My point is there are different ways of getting it down. Did we get it down by cutting spending? Did we get it down by taxing? Or, did the economy grow better than expected?

Dr. RIVLIN. Let me respond to that. The President's 1993 deficit reduction package, which passed without any Republican votes was about half and half—half spending cuts and half tax increases. And—

Senator NICKLES. Dr. Rivlin, I will give you these papers—

Dr. RIVLIN. Could I just finish my sentence?

Chairman DOMENICI. Sure.

Senator NICKLES. I will be happy to submit these papers to you, and again, if you can show \$1 wrong—I do not show any spending cuts from this Administration since 1993. If I am wrong by \$1, I would like for you to show me.

Dr. RIVLIN. Fine, but let me respond. We estimated, in advance, that the 1993 plan would result in about \$500 billion of deficit re-

duction over 5 years, about half would come from spending cuts and about half would come from in tax increases. But we have done much better than that. The 1993 plan has reduced the deficit by more than \$700 billion, and more than 50 percent of the increase has come from faster spending cuts than we originally estimated.

Someone said earlier that the President had talked about big government being dead, but he was not doing anything about it. We have reduced the size of Government, especially the number of people working for the Government. Those people who have left the Government are not being paid anymore. That is a very considerable reduction.

Finally, on your point about reestimates, it is true that the deficit outlook has improved, and one of the reasons why—and these are technical reestimates, as you say—is because health care costs are not rising as fast as they once were. The slower rate of growth in health care costs means that we now have smaller outyear increases in spending projections for medicare and medicaid.

We are proposing cuts, in both medicare and medicaid, to further reduce the rate of growth, but the deficit outlook has improved somewhat because health care costs are simply not rising as fast as they once were.

Chairman DOMENICI. Excuse me, Don. You do not take credit for cutting the program when the technical reestimates say we were wrong on what it was going to cost, to let us make sure we put down what it really costs?

Dr. RIVLIN. I understood the Senator to say that the reduction in the outyear deficits was partly due to a change in the baseline reestimates. He is right about that, but that's the way the world is. The world has, in some ways, gotten better. Inflation is down, growth is up. All of those things are helpful. They do not solve the deficit problem, but they do help.

Senator NICKLES. Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator Nickles.

Senator Boxer?

Senator BOXER. Thank you, Mr. Chairman.

Dr. Rivlin, I am going to congratulate you on three things. First of all, I congratulate you also on this great appointment to the Fed, where I hope that you will balance the fight against inflation with the fight for economic growth. I think that balance is very important, and we need you there.

I look forward to working with my colleagues in confirming you because several of us—Senator Dodd, Senator Murray, Senator Sarbanes and I—are on the Banking Committee, and we will have that opportunity and look forward to hearing from you at that time.

The second thing I want to congratulate you on is this budget, and I am not sure that my colleagues know this, but I went back and looked at who was the last President who submitted a balanced budget using CBO numbers. Well, first, I found out that 21 years ago, the CBO was founded, and then I found out that you are the first Administration to ever use CBO numbers and balance the budget.

I think that is something that is tremendous progress, and I think it is something that Republicans and Democrats ought to be

proud of. To me, it is a little bit like President Nixon going to China and President Clinton balancing the budget—the first President to do that using CBO numbers.

So I think it is pretty momentous. Now, we could disagree, as members of the Republican Party and Democratic Party, on how you get there—and as you know, there is going to be disagreement, and that is why I look forward to seeing the Republican budget. I want to line it up next to President Clinton's budget, we are going to have a Presidential election, and the people will decide if they want to make investments in education, if they want to make investments in technology, if they want to make investments in the environment.

So the people will decide this, because clearly, there is more than one way to balance the budget. I think it is going to make for a very good election year because it is going to be out there—both the record and the future.

I also want to congratulate you on meeting two campaign promises of President Clinton, and you played a key role. One is cutting the deficit in half in 4 years—and Senator Nickles raises some good points—did we have better economic growth which helped us get there? Yes. Are we proud of that? Yes. Certainly it is part of the policies of this National Government that really sets the atmosphere for economic growth. It does not happen all by itself. It happens with the private sector, it happens with the public sector.

The other point on that is the 8 million new jobs which were promised by this President. Those 8 million new jobs came to be. It does not mean they are all perfect jobs. It does not mean there is not anxiety out there. We all know that. Secretary Reich and President Clinton have addressed that and must continue to address that.

So congratulations on all of those things.

I have a question. Some of my colleagues on the other side of the aisle have criticized the President's budget for making deep cuts in the later years which they say are unlikely to occur. Would you compare the cuts made in the President's budget in the later years with those cuts made in the later years under the reconciliation bill sent to this President by the Republican Congress?

Dr. RIVLIN. I am not sure I have the exact numbers for the reconciliation bill, but the latest Republican budget often has a similar pattern of savings to our budget. In other words, I think about 61 percent of the Republican budget plan savings occurred in the last 2 years as opposed to 62.6 percent in our budget.

Senator BOXER. OK. So there were more cuts in the outyears in the Republican budget than there are in the President's budget.

Dr. RIVLIN. Right, about the same.

[The following was subsequently supplied for the record by Dr. Rivlin:]

As I will explain below, it would make more sense to compare the President's budget with the latest Republican offer. These two plans have very similar patterns of budget savings over time, as displayed in the charts which follow. In particular, the first set of numbers in the chart show that the President's budget, using CBO's economic and technical assumptions, achieves 62.6 percent of its savings in the last 2 years, while the latest Republican budget offer achieves 61 percent of its savings in the last 2 years.

It would be somewhat misleading to compare the vetoed Reconciliation Bill with the Administration's balanced budget plan. Because the groundrules for the two

plans were quite different, the policies chosen were different as well. Let me explain why.

There have been two CBO baselines used in the budget negotiations. The first was issued early in 1995, and updated in the summer; this was the baseline for the vetoed Reconciliation Bill. The second was released in December of 1995; this was the baseline used for the Administration's balanced-budget plans, and for the Republican offers in the negotiations.

The two baselines had approximately the same deficit in 2002; however, the December baseline has significantly lower deficits in the early years. Because of the lower early-years deficits in the December baseline, the Republican Leadership in the Congress revised their Reconciliation plan immediately after it was released.

It would be more meaningful to compare the Administration's budget with the Republican offer formulated under the same, December baseline. Because these two plans were designed to hit the same target, they provide a better comparison of priorities and savings.

AMOUNT OF "BACKLOADING" IN THE TWO BUDGET PLANS

	1996	1997	1998	1999	2000	2001	2002	Total	% In Last Two Years
TOTAL SAVINGS									
Administration, CBO scoring	15.9	17.5	30.8	66.1	91.3	142.4	228.8	592.8	62.6%
Administration, OMB scoring	15.5	4.3	22.7	58.9	90.7	116.0	152.9	461.0	58.3%
Republican January 6 Offer	14.0	19.0	35.2	71.5	102.9	149.9	228.8	621.3	61.0%
									% In Last Two Years
DISCRETIONARY ONLY									
Administration, CBO scoring	8.8	10.2	15.6	35.7	51.4	78.9	96.6	297.2	59.1%
Administration, OMB scoring	7.5	7.1	9.9	28.9	43.6	48.4	40.4	185.8	47.8%
Republican January 6 Offer	13.5	23.7	30.5	46.0	58.3	78.4	97.9	348.3	50.6%
									% In Last Two Years
DEFICIT									
Administration, CBO scoring	158.0	164.2	150.0	126.2	108.7	62.1	(7.6)	761.6	
Administration, OMB scoring	145.6	140.1	98.0	64.4	27.5	(8.3)	(43.9)	423.4	
Republican January 6 Offer	159.0	164.0	149.0	126.0	103.0	63.0	2.0	766.0	
(INCLUDING CORPORATE SUBSIDIES)									% In Last Two Years
SPENDING CUTS									
Administration, CBO scoring	19.2	31.4	46.8	84.9	116.6	162.4	231.1	692.4	56.8%
Administration, OMB scoring	16.8	21.9	36.8	76.4	112.1	138.4	176.1	578.5	54.4%
Republican January 6 Offer	28.0	53.0	74.0	112.0	144.0	184.0	233.0	828.0	50.4%
(EXCLUDING CORPORATE SUBSIDIES)									% In Last Two Years
SPENDING CUTS									
Administration, CBO scoring	17.4	23.9	37.7	75.1	106.2	151.2	218.4	629.9	58.7%
Administration, OMB scoring	17.1	16.3	29.5	67.1	102.1	128.1	164.0	524.2	55.7%
Republican January 6 Offer	26.0	50.0	71.0	108.0	140.0	179.0	228.0	802.0	50.7%
(EXCLUDING CORPORATE SUBSIDIES AND ETC)									% In Last Two Years
SPENDING CUTS									
Administration, CBO scoring	17.4	23.2	36.9	74.3	105.4	150.3	217.5	625.0	58.8%
Administration, OMB scoring	17.1	15.4	28.5	66.1	101.1	127.1	163.1	518.4	56.0%
Republican January 6 Offer	26.0	47.0	68.0	105.0	138.0	177.0	226.0	787.0	51.2%

Senator BOXER. And I think that that is very important. When people throw stones, I think they ought to look at their own budget.

Finally——

Chairman DOMENICI. Senator, what was the statement? I did not hear you?

Senator BOXER. Well, I hope I will still have my 30 additional seconds.

Chairman DOMENICI. Of course.

Senator BOXER. I said that there is a lot of criticism on your side of the aisle that this budget back-loads the cuts, and I was asking how many of your cuts were back-loaded in your reconciliation bill, and she said there were more cuts back-loaded in the Republican——

Dr. RIVLIN. Similar savings in the last 2 years.

Senator BOXER. More savings in the last 2 years in the Republican budget than in this one. So maybe we all have to work a little harder and not cast stones at one another.

My last point is really directed at Senator Nickles' comments, and I will be very brief. As I understand your cuts that you are proposing off the baseline in the 7-year period, there would be \$297 billion in discretionary, \$124 billion in medicare, \$59 billion in medicaid, \$45 billion in welfare reform, other mandatory cuts, \$49 billion; there would be tax cuts of \$100 billion, corporate loophole closings of \$62 billion—with a total savings of \$593 billion. That is my understanding. And these cuts are not as deep as what we have seen the Republicans come up with in medicare, medicaid. The tax cut is not as large as their tax cut, and perhaps we have a little more in corporate loopholes. But I just feel that the statement that there are no spending cuts is simply not true, and I would like you to briefly comment on that, please.

Dr. RIVLIN. That is exactly right. We are proposing deep and severe spending cuts. The \$297 billion in discretionary spending cuts is very serious, as is \$124 billion in medicare savings and the other savings that you enumerated.

You are quite right when you say the Republican budget contains cuts that are even more severe. That is because they want to provide a larger tax cut and still reach balance in 2002.

Senator BOXER. Thank you very much.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator Boxer.

Senator Brown?

Senator BROWN. Thank you, Mr. Chairman.

Dr. Rivlin, you have given us an interesting document, and I think the committee is anxious to explore the recommendations that you have for us.

I noticed in your testimony that you referred to a government that is "leaner, but not meaner" and focused on Vice President Gore's work, along with the comment that you are looking for a government that works better and costs less.

Obviously, cuts that come from improving efficiency rather than cutting programs is something that we all ought to be interested in. It is indeed the way to make it work better, instead of having less.

One of the most puzzling things to me has been the Administration's very strong opposition—and you may wish to describe it in different terms—but at least my impression has been, extremely strong opposition to the reorganization of the State Department. I am advised that that could well save \$2 to \$3 billion over a 5-year period and that it would be achieved by combining agencies that perform similar functions—USAID, U.S. Information Agency and others—with the State Department by eliminating duplicate overhead and duplicate functions.

If you are looking for ways to make government more efficient, why the adamant opposition to the State Department reorganization?

Dr. RIVLIN. I would not describe it as "adamant opposition," Senator. It is just a different way of looking at how foreign affairs

agencies ought to function. We have concluded that while there are substantial savings to be had within those agencies, combining them will not produce great savings and might actually make it more difficult to run some of them, especially AID and the U.S. Information Agency.

Senator BROWN. Just as an observation, these are functions that really were separated out as a function of our cold war experience and dealing with the Soviet Union. They are personnel who work together, who have oftentimes complementary skills. My recollection is that our own Secretary of State originally favored this. It is favored by a wide number of former Secretaries of State of both parties. It would save huge amounts of money and simply eliminate a needless bureaucracy.

My hope is that you all would take another look at that. Of all the areas that we work on, this surely ought to be an area where we could find common ground.

Dr. RIVLIN. It would be a very good area to work together on; I certainly agree with that.

Senator BROWN. I think it is, and I find it so frustrating, because we have really had nothing but a filibuster in the Senate on it, both in committee and threatened on the floor and in conference. If the intent is to save money and make us more efficient, this ought to be the easy money, not the tough.

I noticed you referred to a cut of 200,000 people from the Federal work force. Can you advise me how many of those have come from military-related positions and how many have been non-military positions?

Dr. RIVLIN. If somebody will give me the numbers, I can do that, but a substantial number, due to military downsizing at the end of the cold war, have come from the Defense Department.

All of the 200,000 are civilians, but many of them are civilians who worked for the Defense Department.

Within the civilian agencies—and I can give you this table—there has been a substantial decrease in the number of personnel, but there also has been an increase in the number of Justice Department personnel; we are employing more law enforcement personnel because we are building more prisons, which need to be staffed. So the reduction in the domestic agencies is being offset, in large part, by the increase in law enforcement and justice. But I can give you the whole table.

Senator BROWN. Is there a net cut in non-defense employment?

Dr. RIVLIN. Yes.

Senator BROWN. I must say my impression is that there has been almost nothing done in non-defense areas.

Dr. RIVLIN. No, that is not true. A large number of agencies have substantially reduced the size of their workforces. General Services Administration, NASA, Transportation, the State Department, to which you referred, all go down; Commerce does as well. Most of the domestic agencies have reduced the number of their personnel, but some have seen increases; the most notable one is the Justice Department.

Senator BROWN. Mr. Chairman, I see my time has expired. I would ask Dr. Rivlin, if she is comfortable with it, for her folks to give us a summary of the net impact on the non-defense side.

Dr. RIVLIN. I have it right here.

Chairman DOMENICI. Do you know what it is? Do you know what percent of the alleged reduction comes from military and what percent comes from non-military?

Dr. RIVLIN. Yes.

Chairman DOMENICI. What is it?

Dr. RIVLIN. Defense is 17 percent, and non-defense is 6 percent.

Chairman DOMENICI. That does not equal 100.

Dr. RIVLIN. No; those are reductions in the force.

Chairman DOMENICI. What is the percent? Would you just add those two and take 17; is that what you would do?

Dr. RIVLIN. I am talking about the size of the reduction that has occurred between 1993 and 1997. Civilian——

Chairman DOMENICI. Dr. Rivlin, there are lots of stories around—and we want you to verify it—that say that 85 percent of the reduction in the work force has come from defense and 15 percent from civilian. That is the story that is around, documented by somebody. Are they right or not?

Dr. RIVLIN. No, they are not right. Non-defense agencies account for 41 percent of the 1995 reduction, for example.

Chairman DOMENICI. Yes, but that is not the question. Would you just supply us for 1994, 1995, and 1996, specifically——

Dr. RIVLIN. Yes, we can do that very easily.

Chairman DOMENICI [continuing]. And then combined—separately and the combined, the percentages each year?

Dr. RIVLIN. Yes, absolutely.

Chairman DOMENICI. Thank you.

Senator Murray, you are next.

Senator MURRAY. Thank you, Mr. Chairman.

I want to join my colleagues in welcoming you here today, Dr. Rivlin and, as many have noted, wish you well in your confirmation hearing before the Senate for the Federal Reserve. We will very much miss your leadership and your budget expertise but wish you well in your new position.

Mr. Chairman, I note that today is the first day of spring, and I take it it is a good sign that our committee is holding this hearing on the first day of spring; it sort of symbolizes renewal and freshness and new starts, and I think all of us remember too well the budget impasse of last year and the tremendous frustration we felt. Hopefully, today's hearing, since it is on the first day of spring, will start us down a new and brighter and more successful path for this year.

Dr. Rivlin, I do commend the President and you for putting together a very fair and honest budget that does balance in 7 years, but still maintains valuable funding for education, job training and the environment.

I recently spent 2 weeks in my State, traveling to a number of small towns and larger cities and brought people together—Democrats, Republicans, Independents—to talk about what we as adults need to do to improve the lives of our young children today. And over and over again, the loud and strong message was that we need to invest in education—it is the most critical thing we can do in this country—that we have to prepare our children for the ever-changing global marketplace that they are going to be entering.

Unfortunately, the budget proposal that passed this Congress last year would have cut \$70 billion out of Federal education assistance, and I want to reiterate today my strong support for investing in our children and their future. It is absolutely critical that we do that, and I commend the President for taking those steps in his budget.

In addition, many children in my home State and across this country depend on medicaid funding for their health care, and I was very concerned last year when the budget proposals that came out of this Congress pitted groups of people against each other, or would have forced States into those decisions and pitting perhaps young children against our elderly frail individuals.

I commend the President and appreciate the fact that in his medicaid proposal, he does not force our States to do that.

I think it is important that we do remember that many of our medicaid recipients are our poorest children, the most needy, and it makes a lot of sense for us to invest in their health care when they are young, so that we do not put another obstacle in their lives as they try to be successful.

Mr. Chairman, I notice, as many of our fellow colleagues have done, that we have made great progress in reducing the National deficit; we have nearly cut it in half since 1993, and it is important that we stay on that course. I think all of us want to reach a balanced budget compromise, but I also feel strongly that there is a right way and a wrong way to do that, and over the next several weeks and months, we are going to have to ask ourselves, should we have tax cuts, how do we take care of medicare and medicaid, how much do we cut them by, what is discretionary spending going to be, and how do we invest in education and the environment.

I very much look forward to working with my colleagues on this committee to produce a budget that not only balances by the year 2002, but is a budget that is balanced in terms of the needs of especially our children and our young people as we go into the next century.

Mr. Chairman, with my remaining time, I would like to ask Dr. Rivlin a question, particularly on medicaid, which I mentioned. I see that the President's proposal cuts \$59.1 billion, which actually looks very similar to the January proposal that we looked at. But can you tell us what growth rate your budget assumes to get to that figure for us?

Dr. RIVLIN. The growth rate ratchets down. We start where we are and ratchet it down so that, in the outyears, the per capita growth rate grows at the GDP's rate of growth. GDP's as you know, this proposal controls growth by controlling the rate of growth of each State's per capita spending meaning the——

Senator MURRAY. Is there a specific percentage in your proposal?

Dr. RIVLIN. I have forgotten the exact per capita amounts. For the overall growth rate in medicaid, we are assuming 11.3 percent in 1997, 5.4 percent in 1998, 4.7 percent in 1999, and so forth. But I think the important thing is how the per capita amounts are controlled, and I will get you that for the record.¹

Senator MURRAY. I would appreciate that very much.

¹ Answer can be found in written questions to Dr. Rivlin, p. 322.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator Murray.
Senator Frist?

Senator FRIST. Thank you, Mr. Chairman, and I would just ask that my opening statement be made a part of the record.

Chairman DOMENICI. Without objection, so ordered.

[The prepared statement of Senator Frist follows:]

OPENING STATEMENT OF SENATOR BILL FRIST

Mr. Chairman, I thank you for holding this hearing and join you in commending Dr. Rivlin for her decades of service in Federal budgeting. Dr. Rivlin, I wish you the best in your position at the Federal Reserve.

I appear before the committee today with considerable disappointment that we are discussing next year's Federal budget before we have reached agreement on last year. The American people are still waiting for us to balance the budget. They are still waiting for us to dismantle inefficient Washington bureaucracies and end Washington micromanagement of programs. They are still waiting for us to save medicare from bankruptcy, especially since it is already running a deficit. They are still waiting for us to reform a welfare system that discourages work and traps Americans in a cycle of dependency. They are still waiting for tax relief that helps families and encourage investment and job creation.

Last year, the Republican Congress responded to these concerns by passing the Balanced Budget Act. Unfortunately, the President vetoed it. So, today, we return to this committee to debate the same issues again. However, I remain optimistic that discussion of the President's 1997 budget will lead us one step closer to resolving the budget impasse.

As we begin our discussion today, I encourage us to keep this budget process in perspective. The budget is not about the OMB, CBO, GDP, CPI, or any other technical reference used by Beltway budgeteers; the budget is about the American people and their jobs, their incomes, and their quality of life. As President Reagan once said, "Government is the people's business, and every man, woman, and child becomes a shareholder with the first penny of tax paid." By running up a \$5 trillion Federal debt, the Federal Government has demonstrated poor stewardship of their shareholders' investment. As Senators, we have a responsibility to make wiser choices with the hard-earned money entrusted to us by the American people.

Budgets also require looking beyond today to plan for the future. Planning for the future requires the willingness to look beyond the next election and the courage to make tough choices. Unfortunately, the President seems unwilling to think long-term. The President's budget puts off most savings in the automatic pilot entitlement programs until after the '96 elections. And most of the savings that could occur this year are used to boost discretionary spending, not balance the budget. As most of my colleagues know, by 2012—just 16 years from now—entitlement spending and interest on the debt will consume all tax revenues, leaving not a single penny for defense, national parks, education, biomedical research, or any other discretionary priority. If we thought this year's appropriations fights were bad, they will only get worse over the next decade if we do not act to reform entitlements. We cannot wait any longer. We need to transform Washington from a 2 year town that looks to the next election to a 20 year town that looks to the next generation. I hope members of both parties—Republicans and Democrats alike—will embrace these goals and pursue a more responsible budget course in the future.

Thank you, Mr. Chairman.

Senator FRIST. Dr. Rivlin, I want to join everybody else in their best wishes for your future at the Federal Reserve.

I would like to talk briefly about one of the trigger mechanisms in the budget, and I guess it comes from being new in the United States Senate and recognizing that the American people really do not trust—and probably for good reason—promises that are made off into 6 or 7 years from now, especially when it comes to cuts, because any new people who come to Washington are probably going to turn that on end for political reasons, if nothing else.

On page 13, on the trigger mechanism, it says:

In case the new assumptions produce a deficit in 2002, the President's budget proposes an immediate adjustment to the annual limits or caps on discretionary spending, lowering them enough to reach balance in the year 2002.

And again, based on what we have all witnessed this year in terms of the battles for discretionary spending, it just seems to me that lowering the cap on discretionary spending at some time in the future is difficult to sell. Is it really realistic?

Dr. RIVLIN. Well, this is only a failsafe mechanism. We believe the budget we have put forward will balance, actually more than balance, in 2002 as scored by the Congressional Budget Office. We have worked very hard to make sure that is true. We have sent CBO our language, and they have looked at some parts and said, "Well, we would not score that in quite the same way." In many cases where that happened, we adjusted our proposals to ensure CBO scoring. Medicare is a good example. We are really sure CBO will score those savings as \$124 billion over 7 years.

So we are quite certain that, when CBO scores it, we will reach balance in 2002. However, we cannot be absolutely certain, because CBO will take a new look at the economy and they may come out with some slightly different assumptions. Thus, we put in a failsafe mechanism so that if CBO releases new estimates, and we do not expect them to be very different from their old estimates, we will close the gap by changing the existing law to lower the discretionary caps. We can then say with confidence that CBO will score our budget as balancing in 2002.

Senator FRIST. I guess the way anybody scores it, whether OMB or CBO, with the realities of the way Washington works, I have great concern, and I am disappointed in this budget because we do not really address many of the entitlement issues nearly as much as I think we might.

Dr. RIVLIN. I think we do address them in a very serious way. Half of savings come from entitlements, and for the three big items—medicare, medicaid and welfare we have very serious proposals to reduce spending growth rates in a way that we think will make the programs work better.

Senator FRIST. But I mean instead of just the numbers themselves, if we look at, for example, medicare, which you mentioned, affluence testing. Right now, the President's budget does not include an affluence test of any sort for Part B physician payments, Part B premiums.

Dr. RIVLIN. That is right.

Senator FRIST. In fact, the President through his veto of the Balanced Budget Act vetoed a proposal to put affluence testing on the table, and it has been done in a bipartisan way in the House and in a bipartisan way in the Senate through various groups.

Why does the President not think an affluence test is reasonable today?

Dr. RIVLIN. We did not think it was necessary to reaching our goals for medicare savings. We thought that adjusting the provider payments to reduce the rate of growth in medicare would give us \$124 billion in savings over 7 years. I do not think it is a matter of principle particularly, but we didn't think affluence testing was necessary to achieve the goal we had set.

Senator FRIST. I understand that you can ratchet down on providers continually. At some point, it is hard for us to explain to the American people why Ross Perot-type people are being subsidized by their secretaries, who are out there working every day; their Part B premium is being subsidized. Therefore, it is hard to understand when we look at entitlement reform why the President opposes that type of affluence testing.

Dr. RIVLIN. It is not in our budget, but it is certainly something that we ought to talk about.

Senator FRIST. I see my time is up. Let me just ask one quick question, finally. It looks like for medicare spending that under the President's proposal, growth is slowed to 7.9 percent—I believe that is correct. Under the proposals that have been put on the table by Congress, most recently, it has been 7.4 percent.

Realistically, long-term, do you think either of those are sustainable in our budget?

Dr. RIVLIN. Doctor, you might know more about that than I do, but I think it is hard to say how much room there is for greater efficiency in the Medical Care System. As more of our population ages, the Medical Care System, especially for seniors, will be under increasing pressure. The technology gets better and better, and in some cases that means less expensive care, but in most cases it means more expensive care.

So I am nervous, as you are, about our prospects for achieving lower growth rates forever, but I think that as we make the Medical Care System more efficient in the next few years, those are realistic growth rates.

Senator FRIST. Thank you.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator Frist.

Senator Dodd, on your side, Senator Sarbanes did come in for moment way back yonder; does that make him next on your side, or are you next, Senator Dodd?

Senator SARBANES. I will yield.

Chairman DOMENICI. Senator Dodd?

Senator DODD. Thank you. Thank you, Mr. Chairman, and I will try not to use all the time.

First of all, let me join in the chorus of praise, Dr. Rivlin, for your nomination to serve on the Fed. Those of us on the Banking Committee look forward to your coming before us for the confirmation hearing.

Dr. RIVLIN. Thank you.

Senator DODD. And let me also commend you for what you have accomplished here during your tenure at the Office of Management and Budget. I almost get the sense that some people are upset over the fact that we have been able to cut the deficit in half and that this is terrible news.

Now, you have put forward a budget that for the first time, as has been pointed out, uses CBO numbers. We have heard that cry day in and day out for months, and now it is answered. In fact, the \$593 billion in cuts over 7 years would yield a surplus.

Just editorially, for my own part, I frankly would have postponed the tax cuts. That is my own point of view on this, but I have had that view for some months. I would delay that \$100 billion until

we ended up with the budget in balance; it would certainly make it a bit easier for us to achieve that, but I am not going to quibble about that.

So I am somewhat mystified over the kind of reaction we get to the achievement that has been made here. And the best evidence is not what we say around this horseshoe table, but how Wall Street and Main Street react to this, and the fact that we have seen generally positive reaction over the last several months.

The markets are reacting to what has happened and have reacted very, very positively. And again, the fact is that we have moved aggressively on this issue, as has been pointed out on numerous occasions—for the first time in literally almost a half a century, we have had 3-consecutive years of deficit reduction, clearly marching us in the right direction for the first time. At the same time, we have been able to reduce the size of the Federal work force—and we will get from you the percentages and how that works in terms of how much was defense or non-defense—but back between 1981 and 1988, we had a 183,000-person increase in the Federal bureaucracy—we increased the Federal bureaucracy by almost 200,000 people during that 8-year period—and in this 37-month period, we have been able to bring that number down, and we have actually cut in the neighborhood of 245,000. Now, obviously defense or non-defense clearly has some impact, but we are clearly moving in that direction.

We have watched for the first time regulations—some 16,000 to 17,000 pages of Federal regulations—under the leadership of the Vice President stripped out of the Federal bureaucracy.

I think that is part of why you are getting this kind of reaction, because of those decisions that have been made to make this Government more efficient and to respond to the legitimate concerns that have been raised in the private sector about a regulatory scheme that can be burdensome.

But the best news has been this commitment to getting the deficit down. Now, I am still hopeful that we can get some resolution of the 1996 budget, and that might come in the next few days. I think the President is committed to that, and I believe the leadership here in Congress is committed to it as well, so I am hopeful that that will occur.

Chairman DOMENICI. Do you mean the appropriations finale, or are you talking about a big package of balanced budget—

Senator DODD. I am talking about a big package. I would like to see that happen, and I think the President would as well, from my conversations with him; and I believe the leadership here is committed to it as well, so I am still hopeful that can happen. And you may want to comment on that, but obviously, you are not going to get the kind of growth we need in this country unless the markets are convinced that we are moving in the right direction.

This President arrived in town 37 months ago—not 35 years ago—37 months ago. He was never in Congress, was never a Senator, never served in the Cabinet, and laying at the doorstep of 1600 Pennsylvania Avenue was a \$4 trillion debt, \$3 trillion of which had been accumulated in the 12 years prior to him coming to town. And in the 37 months he has been here, he has cut the annual deficit in half. And, frankly, instead of bemoaning it, we

ought to applaud it and then work together to continue that process.

So I commend you for what you have done.

Dr. RIVLIN. Thank you, Senator. I could not agree more, and our record on deficit reduction is very strong.

Let me clarify my answer in response to the Chairman's question about staffing reductions. For the period 1993 through 1997, including the proposals in this budget, we estimate a reduction of 245,000 full time equivalent employees working for the Federal Government. Of that, amount 164,000, or 67 percent, are defense civilians, and 81,000, or 33 percent, are non-defense civilians.

Chairman DOMENICI. Well, I thank you. Had you not done that, I would have read you your numbers. Sixty-seven percent of the personnel cuts are defense, and the balance are civilian.

Dr. RIVLIN. That is right. Sixty-seven percent are defense civilians and 33 percent are non-defense civilians.

Chairman DOMENICI. Were you finished, Senator?

Senator DODD. The only other point I was going to raise—my colleague from Tennessee raised the issue of means-testing. I have long held a view on means-testing in medicare. We should remember however, that the median income of a medicare recipient is \$17,000 a year; and for a woman over the age of 65 on medicare, the median income is \$8,500 a year. So when we start talking about Ross Perot and others, we are talking about an infinitesimal fraction of the population. In fact, as I understand it—and you can correct me if I am wrong—about 98 percent of all medicare recipients earn less than \$50,000.

So there is not a lot of money involved, and I have tried to argue the case in the past, and it has been pointed out to me that you just do not get that much out of it. That ought not be a reason to be against it, but there is not a whole lot of savings at a means-test level that we would probably accept in Congress. I presume we would be talking in the \$100,000 range or something like that that would be the politically acceptable level if you could get some agreement on it. But the savings as a result of doing that, as I have always been told, is so minimal that it did not really make that much of a difference. Now, if I am wrong on that, you correct me, but that has been the argument I have received.

Dr. RIVLIN. There are not a lot of elderly people in that income group. I think a means test level of \$100,000, depending on how you did it, could raise around \$9 billion over the 7-year period we have been talking about.

Senator DODD. That is pretty substantial.

Chairman DOMENICI. Well, Senator, you are right if you use the phrase "earned income," which I think you did, but you are not talking about earned income. You are talking about all income added up that you pay taxes on, and there is a lot more than the number you use when you get to that.

And I think the issue there—and then I will yield to Senator Snowe—you know, this one is not trust fund money; this is not the one that everybody is paying. This is a family of four with both mother and father working; they are paying income tax, and it goes into paying the premium for senior citizens who earn \$150,000.

Most of those families in America do not earn \$35,000 or \$40,000. That is the inequity of it.

Senator SNOWE?

Senator DODD. I would like to see how that number plays out over 7 years, and maybe pick a couple of income ranges and see what that produces. I do not know if my colleague from Tennessee might be interested in that as well.

Dr. RIVLIN. We could supply that, Senator.

[The following was subsequently submitted for the record by Dr. Rivlin:]

To respond to this question, OMB requested that the Office of the Actuary (OACT) at the Health Care Financing Administration develop estimates of medicare savings from several different income-related premium scenarios. For all three alternative scenarios, it was assumed that the increased premiums are phased in over the first \$25,000 of income above the thresholds. For example, in the first alternative—where single beneficiaries with incomes above \$100,000 are affected—single Part B enrollees would pay the maximum premium at incomes above \$125,000; enrollees with incomes between \$100,000 and \$125,000 would pay a pro-rated percentage of program costs between 25 and 75 percent. The maximum premium charged is 75 percent of Part B Program costs. The estimates also assume that the basic premium is maintained at 25 percent of program costs over the period from 1997–2002.

Using the medicare baseline from the President's fiscal year 1997 budget, and assuming no other changes in policy (i.e., no other proposals for savings in Part B Program costs are enacted), OACT determined that a proposal to income-relate the Part B premium starting at income thresholds of \$100,000 for single beneficiaries and \$125,000 for couples would produce approximately \$5.2 billion in savings over the period from 1997–2002. Alternatively, if the income thresholds were \$90,000 for singles and \$115,000 for couples, such a proposal is estimated to save approximately \$5.8 billion over this time period; if the income thresholds were \$50,000 for singles and \$75,000 for couples, OACT estimates savings of \$11.6 billion.

Note that OACT's estimates are likely to be different from estimates developed by the Congressional Budget Office (CBO) for at least two reasons. First, the two organizations have different projections for medicare spending over this time period in the absence of any policy changes; in particular, it is relevant that CBO's projections for Part B spending are higher than OACT's, which might be expected to result in greater savings from an income-related premium proposal. Second, the two organizations may make different assumptions about how an income-related premium proposal would affect beneficiary behavior and participation in the Part B Program.

Finally, note again the OACT's estimates assume that no other savings proposals affecting Part B Program costs are enacted during the relevant time period. The estimates of savings from an income-related premium proposal are directly affected by this assumption. Otherwise comparable CBO estimates would differ if CBO considered means-testing along with other policy changes.

Chairman DOMENICI. We might also say, Alice—you might confirm this—we will confirm this—but I think the savings that we projected from what we proposed in this area was \$8 billion over 7 years, so it is not something that we should just say should not be considered. That is a pretty big ticket item.

Senator SNOWE?

Senator SNOWE. Thank you, Mr. Chairman.

I too want to join in commending you, Dr. Rivlin, for your nomination to the Federal Reserve Board. You are certainly well-qualified to assume that position, and I want to wish you well.

Sitting here and recapping where we were last year at this point in time, I cannot help thinking that it was at approximately now that we were voting on a constitutional amendment to balance the budget. And I know the Administration differed on this issue, as did many others, and we lost it by one vote in the United States Senate, which was regrettable, because I think that the budget

process to date really underscores the need for a constitutional amendment. I think we have reached a low point in this budget process. It is not that you can balance the budget any old time when you have a constitutional amendment. You have to meet the targets and the deadlines. Both the President and the Congress have to get together, resolve their differences and move forward. That is what States do every year. That is what families do. That is what businesses do.

That is the frustration that I have, because last year, we heard during the debate, "Well, just show your plan." So we lost the constitutional amendment on the floor of the Senate by one vote. So in response to the demand for a "plan," we moved forward for 10 months, we worked on a balanced budget plan, we submitted it to the President in November, and he vetoed it.

Now, the President did campaign on a balanced budget plan; and the fact is that he said he would produce a balanced budget in 5 years. We finally got a balanced budget plan from the President on January 6, 1996 after five attempts at such a proposal. It was not until January of this year that the President responded with a balanced budget after vetoing our plan in November.

The point of all this is that both parties have to come together. A group of us, as you know, are working here in the Senate on a bipartisan basis. We have approximately 22 Senators, equally divided between Republicans and Democrats, and we are close to unveiling our plan. We are now writing out the specifics, while working with a bipartisan group of Governors and a number of other people. As you know we have also met with Leon Panetta in the past.

I would just like to hear from you, Dr. Rivlin, in terms of what the Administration's approach would be on this issue. This is an opportunity to get a balanced budget. We can talk forever and on both sides, but the fact remains that if we really want to get a balanced budget, we have to do it, and that is why I think a constitutional amendment is necessary—but that is beside the point now. What can we do now to ensure that we get a balanced budget this year? And I would like to ask you, when we unveil this proposal—and we are looking for the opportunity in the near future to offer this on the floor—would the President voice his position on this proposal before we take a vote on it?

Dr. RIVLIN. The President has made very clear, as recently as yesterday, that he wants a balanced budget. He has offered a budget that balances in 7 years under CBO numbers. Perhaps we came to this too late, but we have done it now. We have a budget on the table that does balance in 7 years by CBO numbers. And we are very eager to work with Congress, the congressional leadership, and all the bipartisan groups that are working very hard to solve this problem.

I could not agree more—we need to work together on this. I cannot speak for the President as to what kind of message he would send before a vote on your plan. But the President wants very much to work toward a bipartisan solution that will actually balance the budget.

Senator SNOWE. Well, we have a very narrow window, as you well know, and you indicated that in your testimony.

Dr. RIVLIN. Right.

Senator SNOWE. Our plan is the only bipartisan plan on the Hill, which I think is unique as well as significant. And I would hope the President would use this as an opportunity to encourage this process and to voice his position on this issue.

We think it is that important, and it is not often that you can get a bipartisan group to agree on a balanced budget and to lay out the specifics. We split the differences between the President and Congress on all of the key issue areas. We incorporate the National Governors' Association's recommendations on the issues of medic-aid and welfare reform. So I would hope the President would use this as a prime opportunity to move this process forward because we need his leadership on this issue, and I hope we would not lose it at this point.

Dr. RIVLIN. I know the President sees this as a great opportunity over the next few weeks. Now, there are policy differences; there are still considerable differences over medicaid both within the Governors' group, and between the Administration and what the Governors seem to be coming up with. So I cannot promise you there will be a meeting of the minds on particular parts of the budget, but the President does want to work out those differences and get a 7 year balanced budget agreement that everybody is reasonably happy with. But nobody is going to be delighted with it.

Senator SNOWE. Thank you.

Thank you, Mr. Chairman.

Chairman DOMENICI. Senator Sarbanes, you are next, but before Senator Dodd leaves, I would like to make an observation. Senator, your eloquence on budget matters and your articulate stating of the President's great successes has increased every week since you have been chairman of the National Committee of the Democratic Party. [Laughter.]

Senator DODD. Well, I thank you for that, Mr. Chairman, and I am still going to support the Democratic candidate in New Mexico.

Chairman DOMENICI. Thank you very much. Please, do not come out there, Senator. Laughter.]

Senator SARBANES. Especially in his newly eloquent form, Mr. Chairman.

Chairman DOMENICI. Go ahead, Senator.

Senator SARBANES. Thank you.

Dr. Rivlin, I am pleased to see you here, and I join the others first in commending the fine work you have done at OMB and second in congratulating you on your nomination to become a member of the Board of Governors of the Federal Reserve.

Dr. RIVLIN. Thank you, Senator.

Senator SARBANES. I think it is important to focus for a moment on the accomplishments of the President with respect to the budget deficit. As I understand it, the deficit has come down in each year of the Administration's term; is that correct?

Dr. RIVLIN. That is correct.

Senator SARBANES. And from what to what?

Dr. RIVLIN. The deficit has decreased from \$290 billion in fiscal 1992, the year before the President took office, to \$164 billion in fiscal 1995. For fiscal 1996, we estimate the deficit will be \$146 billion, which is about half of \$290 billion.

Senator SARBANES. Now, am I correct that since the end of World War II, we have not had a comparable period in which we have had so many years of continuous deficit reduction? Would that be correct?

Dr. RIVLIN. That is correct.

Senator SARBANES. So this trend, then, is a "first" in the post-World War II period?

Dr. RIVLIN. Yes; Harry Truman, as we have pointed out, did it 3 years in a row, but his advantage was that World War II had ended. But you have to go back much further in history to find 4-consecutive years of deficit reduction.

Senator SARBANES. Now, I understand there is a concept in economics called the "primary deficit," which compares what you take in in revenues compared with what you are spending on programs. Is that correct?

Dr. RIVLIN. Yes, minus the interest; the primary deficit does not count interest.

Senator SARBANES. It excludes the interest on the debt resulting from previous deficits.

Dr. RIVLIN. Right.

Senator SARBANES. So it is a current picture of how to compare your spending programs with the revenues that are coming in; is that correct?

Dr. RIVLIN. Right.

Senator SARBANES. What has happened to that primary deficit over the course of this Administration?

Dr. RIVLIN. It has moved into surplus. If we were not counting the interest we're paying on the debt, we would be in surplus now.

Senator SARBANES. And by how much? I am told that spending on programs over this period has been \$225 billion below revenues raised.

Dr. RIVLIN. I would not second-guess you on those numbers.

Senator SARBANES. OK. I also have material here that indicates that in the previous 12 years, \$660 billion more was spent on programs than was raised in revenues. In other words, in the 1980's and into the early 1990's, in contrast to what has been happening in recent years where the spending has been less than the revenues, therefore enabling us to bring the deficit down, in those years, the spending exceeded the revenues by \$660 billion over that time period.

Dr. RIVLIN. That is right. I do not have the exact numbers but that was the period in which we were building up this debt on which we are now paying the interest.

Senator SARBANES. Now, if we had not built up the debt over that period, so we would not now have to be paying interest on that debt, would our budget be in balance?

Dr. RIVLIN. Yes, it would.

Senator SARBANES. So the thing that is throwing the budget into deficit now, given the progress of the economy over the last few years, is paying the interest on the debt that was built up in those previous years, particularly that very sharp run-up in the 1980's and early 1990's; is that correct?

Dr. RIVLIN. That is right. If we were not paying the interest on the debt that accumulated between 1981 and 1992, we would have a balanced budget now. That is most of the debt, actually.

Senator SARBANES. Well, I think that that is a very impressive accomplishment, and I think it needs to be laid out on the record and made clear that in fact the Administration has brought the budget into balance—more than into balance, actually, into surplus—except for meeting the obligations imposed upon it as a consequence of running deficits in that previous period which built up the debt and require interest payments on that debt.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you very much.

Senator Frist, did you have an additional question?

Senator FRIST. Yes; one final question.

Chairman DOMENICI. Please.

Senator FRIST. Thank you, Mr. Chairman.

This is to follow up on Senator Simon's earlier comments on CPI. There is widespread agreement today among economists that the CPI overstates inflation, including those at the CBO and the Federal Reserve. The advisory commission headed by Michael Boskin believes that CPI is overstated anywhere between .7 and up to as high as 2 percentage points. The Administration's Advisory Council on Social Security incorporated into its estimates a .5 percentage point reduction in CPI, implicitly accepting that a change is necessary and desirable for the long-term solvency of the program.

There have been from both parties, I think, people who have proposed a slight reduction in the CPI. The bipartisan Senate budget group that Senator Snowe mentioned is discussing similar reductions.

Would the Administration support a legislative change in the CPI to correct this upward bias?

Dr. RIVLIN. No, Senator. I think you have put your finger on the difference here. Everybody agrees that there is some overstatement of the cost of living, and the question is do you try to fix that by changing the formulas, or do you legislate it. We believe BLS should fix the overstatement by correcting the formulas. We do not favor a legislated change.

Senator FRIST. And how is that being done? What is the time course? We have heard it bandied about over the last 6 to 8 months, and it is almost as if people on both sides are afraid to come forward; everybody recognizes it, but it is difficult to take that first step, for whatever reason.

Dr. RIVLIN. No; BLS already has taken the first step by adjusting the way it collects and processes the information. Other adjustments may be needed, but BLS is definitely trying to correct for the overstatement.

Economists disagree on how large the overstatement is, and there are some things primarily having to do with the change in product quality that are inherently impossible to measure. So maybe we may never get it just right.

Senator FRIST. But the number is inaccurate, everybody seems to agree, and everybody seems to agree it is too high. So what is the time course of what the Administration is doing to correct that?

Dr. RIVLIN. Well, BLS has a program to correct it. I can ask them to supply you with the time course they are on, but some of these changes already have been implemented and are reflected in our outyear assumptions about the CPI's course.

Senator FRIST. Thank you, Mr. Chairman.

Senator SARBANES. Mr. Chairman, could I make an observation?

Chairman DOMENICI. Yes, certainly. I have not asked any questions yet, but go ahead.

Senator SARBANES. Oh, I am sorry.

Chairman DOMENICI. Please go ahead.

Senator SARBANES. I just want to underscore that I think it is very important that any adjustments in the CPI be done in a way that is perceived to be the consequence of the evaluation of objective factors by experts in the field and not perceived to be done for one or another political reason, whether it is by the Administration or the Congress, because if it is the latter, that issue will then become highly divisive and controversial, and I think it will be with us, so to speak, indefinitely one way or the other.

So it seems to me the way to address this question, since there is a significant body of opinion that thinks there is an overstatement, is for the experts to examine those opinions, to review their formula—which I gather the BLS is doing—and to come in with whatever revisions are necessary which can then be justified by them as having been done according to established and objective criteria which keep that issue out of the political realm. Otherwise, I think we are going to have a great deal of difficulty with that question.

Dr. RIVLIN. I agree with that, and that is the Administration's position.

Chairman DOMENICI. Did you have another question, Senator?

Senator FRIST. No. Thank you, Mr. Chairman.

Chairman DOMENICI. Dr. Rivlin, before I ask a few questions, I would like to, from my own standpoint, make one observation regarding the deficit of the United States and see if I can put it into some kind of practical framework, because I think we ought not be euphoric about things; it is a very serious problem.

My best arithmetic—and I have just jotted it down up here—is that the interest on the National debt is somewhere around \$241 billion. Entitlement programs are 52 percent of the budget. For purposes of some rounding, I would say the interest on the debt is 15 percent of the budget. So I add the 52 to the 15, and that is 67 percent of the budget is interest and entitlements. And then, I looked at defense, because I believe we are going to always have defense, and that is 16 percent or thereabouts.

I think we ought to be very, very worried because if that arithmetic is right, that is 83 percent of everything we spend for interest on the debt, entitlement and defense. That means 17 percent and dwindling is available for everything else we do in government, and since none of that 17 is on automatic pilot—that it, it does not just happen—it is vulnerable each year to the appropriation process, and I can see it going nowhere but dramatically down.

Now, that is just one way of looking at the nature of the problem, but I was talking to an audience not too long ago, and I was trying to think about one of those people being a happy taxpayer, so I just

picked one out, and I said, "Mr. Jones, when you write your check to the Federal Government, maybe that last installment, or when you wrap it up and say 'I just paid my own personal income tax,' would it be fair to say that you are very happy to pay for government?"

I was not getting any answer, so I said, "Well, maybe I will make it a little more difficult. If you knew that all the people like you paying personal income taxes, that the dollar amount from all of you is \$631 billion, and if you knew that out of that, \$241 billion was going for interest, so that 40 percent"—looking at it one way—"of what you are willing to pay to the Government, that you might have been happy about, is all going to interest, might that make you more happy or less happy about paying taxes?"

That did not take long. That brought an answer from him and everybody else in the crowd.

Yet I look around, and I am very unwilling to acknowledge that we have this under control. As a matter of fact, I want to insert in the record—and then I would like you to pick it apart or give me your comments—I have a page in the summary that the budget staff here did which talks about since 1992, what did we really do to get the deficit down, because we have been kind of glibly talking about it as if Congress and the President did some really extraordinary things—I mean, we really restrained government. Well, what I find here is that 35 percent of the savings—35 percent of all of the savings in the deficit—is the result of policy changes. Thirty-five percent. That means 65 percent happened without any policy changes. By that, I mean without actual overt acts of changing the law to reduce the expected expenditures, which some people call "cuts in spending."

Interestingly enough, of that 35 percent, Dr. Rivlin, we have to put in that tax increase, because it was an overt policy that reduced the deficit. And I believe you will find that we have done very little so far to reduce the real programs that spend money in America by policy changes.

Now, we might just whistle along for a few more years and say we can do it through estimating and the like, but sooner or later the reality is going to be there that we have not yet made any real, permanent, significant changes, at least not anywhere close to what you would need to sustain a balanced budget over time. And we will submit the details to you. I think you know what I am talking about, and if you would analyze it your way in writing, we would be very pleased to have that.

[The following was subsequently supplied for the record by Dr. Rivlin:]

According to Budget Committee staff, Senator Domenici was referring to page 7 of "President Clinton's 1997 Budget," prepared by the majority staff of the Budget Committee on March 19, 1996. That page states, in part, "Although the deficit has fallen \$126 billion since 1992, this is more a product of improved growth, resolution of the thrift crisis and the Administration's early tax hike. In fact, if one looks at the standardized employment deficit (which strips out deficit changes attributable to growth alone), one sees that only \$48 billion in real progress has been made—or only 38 percent of the \$126 billion drop we see so often in the headlines.

	1992	1993	1994	1995	1992-95 Change
Total Deficit	290.4	254.7	203.4	163.8	126.6
Standardized-Employment Deficit*, CBO Dec. 95 baseline	220.0	225.0	180.0	172.0	48.0

* Deposit insurance costs have been removed.

You suggest that the President deserves credit only for "actual overt acts of changing the law." I disagree. The President's plan did more than just change the law. Indeed, by reassuring the financial markets that the President planned to attack the deficit, the plan helped to reduce interest rates, thus spurring economic growth. That is, the President deserves credit for the very improved economic situation that you suggest just happened to occur. As you may recall, opponents of the President's plan predicted that it would have just the opposite effect, that it would not only slow growth but even throw the economy into recession. Had that occurred, they were quite ready to blame the President.

Because of changes in economic and technical assumptions since OBRA-93 was enacted, OMB has never revised its estimates of the spending cuts made by the Act. However, the combination of deficit reduction resulting from OBRA-93, favorable technical reestimates, and the accompanying improvement in the economy since OBRA-93 was enacted have brought about successive declines in the deficit. As shown in the attached table, OMB currently estimates that the combination of the above factors has reduced the 1994-98 baseline deficits by a total of nearly \$850 billion. This amount excludes the additional savings proposed in the President's fiscal year 1997 budget.

Furthermore, please consider the following:

1. Regarding the statement: "... if one looks at the standardized employment deficit . . . only \$48 billion in real progress has been made . . ." This claim neglects to consider that, prior to the enactment of the President's economic program, the standardized-employment deficit was increasing. The proper measure of progress is not the decline from the 1992 level, but rather the decline from the 1995 level that would have been obtained without the President's program. In *The Budget of the United States Government, Fiscal Year 1994*, page 7, the baseline structure deficit was projected to increase from \$240.1 billion in 1993 to \$265.8 billion in 1995. We now estimate that the 1995 structural deficit is only \$185.0 billion, or \$80.8 billion lower than would have been obtained without action—and \$26.7 billion lower than the Administration projected, even assuming enactment of our program. Thus, the reduction in the structural deficit is about three-fifths larger than your analysis suggests, and almost one-third larger than the Administration claimed for our own program. (Please note also that all of these are 1 year numbers, and therefore appear smaller than the 5 or 7 year cumulative figures which we have come to use routinely in discussions of the budget.)

2. Regarding the statement: "... [reduction in the standardized-employment deficit is] . . . only 38 percent of the \$126 billion drop we see so often in the headlines" In fairness, as I noted above, the President's economic program deserves credit, not blame, because of its salutary effect on the economy, which has been recognized by impartial economic observers such as Federal Reserve Board Chairman Alan Greenspan and former Fed Chairman Paul Volker. The Administration is pleased and proud that its policies have reduced both the cyclical and the structural components of the deficit, and the fact that the cyclical reduction has been large is good news, not bad. Please note that the economy has been stronger, and the total deficit lower, than either the Administration or CBO projected at the time of the enactment of the President's program.

(Table follows:)

Change In Deficits Since Pre-OBRA Baseline
(in billions of dollars)

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	Actual			1996	1997	1998	1994-98
	1993	1994	1995				
Pre-OBRA '93 Baseline.....	309.7	305.3	301.8	298.0	347.1	387.7	1,639.9
Changes due to:							
Enacted Legislation:							
OBRA '93.....	0.1	-46.8	-82.7	-100.6	-128.9	-145.8	-504.8
Other Legislation.....	5.6	10.7	8.0	3.9	4.1	3.5	30.2
Subtotal, Legislation.....	5.7	-36.1	-74.7	-96.7	-124.8	-142.3	-474.6
Economic assumptions:							
Receipts.....	4.2	-3.5	-12.9	-14.6	-24.3	-38.9	-84.2
Outlays:							
Net Interest.....	-2.0	-7.5	5.8	0.8	-12.0	-29.4	-42.5
Other.....	-0.3	-1.8	-9.7	-8.4	-8.3	-4.9	-33.0
Subtotal, Outlays.....	-2.3	-9.3	-4.1	-7.6	-20.3	-34.3	-75.5
Subtotal, Economics....	1.9	-12.8	-16.9	-22.2	-44.6	-73.3	-169.7
Technical Reestimates:							
Receipts.....	-8.6	-11.7	-10.7	-10.1	-23.2	-33.8	-89.6
Outlays:							
Deposit Insurance.....	-30.8	-15.2	-16.5	4.1	6.2	5.6	-15.8
Other.....	-22.7	-26.4	-19.0	-12.0	-16.3	-23.3	-97.0
Subtotal, Outlays.....	-53.6	-41.6	-35.5	-7.9	-10.1	-17.7	-112.8
Subtotal, Technicals....	-62.2	-53.3	-46.3	-18.0	-33.3	-51.5	-202.4
Total Changes.....	-54.6	-102.2	-137.9	-136.9	-202.7	-267.1	-846.7
1997 Budget Capped Baseline....	255.1	203.1	163.9	161.2	144.4	120.6	793.2
Memorandum- Composition of OBRA Savings							
Receipts.....	-0.1	-27.4	-46.9	-54.3	-62.8	-58.6	-250.1
Outlays.....	0.1	-19.4	-35.8	-46.3	-66.1	-87.2	-254.7
Total.....	0.1	-46.8	-82.7	-100.6	-128.9	-145.8	-504.8

Chairman DOMENICI. I said yesterday, and I do not change the statement one bit, that to the extent that we are engaged in a political battle—and I do not know that I am even being necessarily disparaging of the President—your budget is a magnificent political document—and maybe that is what it ought to be. Maybe that is what it ought to be.

For instance, we cannot find any domestic appropriated program that you have eliminated, and we would like the details if there are going to be some. What we have are all increases—no eliminations and no specific cuts.

We would like to know when the first year is up, Dr. Rivlin, when we have gotten through the election—and whoever is elected President, there is going to be a President elected this next time who has to do the next budget—what we would like to know is, if you keep your priorities on appropriated accounts, we would like to know how much you have to cut out of all the rest of the domestic accounts, if you could tell us.

Now, I will tell you for the record that I think over the balance of the time, you have got to cut the rest of them 30 percent over the 7 years.

Dr. RIVLIN. We estimate that you would have to cut them by 22 percent over the first 5 years. After that, we think we will have our trigger restoring funds to these programs. But I do not think those numbers are particularly inconsistent. The point you are making is the right one, these are severe cuts, and they will bite.

Chairman DOMENICI. No, that is not my point. My point is if you accept my analysis, which I believe is correct, that a great deal of

time and effort has been put into making sure this is a very good political document to run on—it has all the pluses, so we can run across the country talking about everything we are going to add something to, but there is very little, if anything, in here saying what happens with any degree of specificity—which is nice; you do not have to tell the public what you are going to cut—there is nothing very specific about it.

Now, if you want to supply for the record—maybe you now know what you are going to cut and what you are going to restrain and how much that is—I would like to have that.

[The following was subsequently supplied for the record by Dr. Rivlin:]

In his fiscal 1997 budget, the President proposes to terminate more than 100 programs and projects which stretch across various executive branch departments and agencies. These terminations would reap savings of more than \$4.5 billion in defense and non-defense programs and projects in 1997 alone.

For example: terminations in the Agriculture Department include savings from buildings and facilities; Commerce Department terminations include the National Textile Center Grant Program; Defense Department savings include the Armored Gun System; The President proposes to save \$624 million from the Department of Housing and Urban Development Preservation Program; and Interior Department savings include \$64 million from the Bureau of Mines. Overall, non-defense terminations fall within the jurisdiction of 15 departments agencies, and commissions.

I want to also note that, working with Congress over the last 3 years, we have already eliminated 148 defense and non-defense unnecessary or lower priority programs and projects.

Spending on non-priority, non-defense accounts, by fiscal year 2000 would have to be reduced by approximately 22 percent in the aggregate (below the fiscal year 1995 level), but by the year 2000 would increase roughly to a freeze (compared with fiscal year 1995) due to the fiscal dividend.

Senator DOMENICI. Now, let me just make two more points. Dr. Rivlin, you passed over very quickly Senator Frist's questions about the \$60 to \$65 billion—I am sorry, it was Senator Gregg—that you have transferred from the Medicare Program and put that burden on the insurance program instead of the Medicare Program.

Dr. RIVLIN. They are both medicare, Senator.

Chairman DOMENICI. I understand.

Dr. RIVLIN. It is a question of Part A and Part B.

Chairman DOMENICI. I understand that very clearly. We have had in Part A home health care, and that costs \$60 to \$65 billion. And what this Administration has done in this budget is, very simply, taken that \$60 to \$65 billion and said it is no longer a responsibility of the Trust Fund. What does that do? That makes the Trust Fund look nice and healthy, without doing anything to change Part A, the Hospital Program. But what it does is it puts the \$60 to \$65 billion into the Part B health care for the seniors, which is an insurance policy as I understand it for everything except hospitals—is that a fair statement—primary care, everything except hospitals—and we will subsidize that soon to the tune of 75 percent from average taxpayers. You have just put home health care down there and said we are making the Hospital Program solvent to the tune of \$60 billion.

I do not believe that is a fair way to do it, and I think it just hides and masks the problem we have in the combination of the two.

Dr. RIVLIN. We could argue, Senator, about what should be in Part A or Part B, but collecting the two together, we are proposing \$124 billion in cuts over 7 years. That is not trivial.

Chairman DOMENICI. I am surprised that you would call it cuts.

Dr. RIVLIN. Savings, if you will.

Chairman DOMENICI. I think it will still grow very fast.

One last observation, and then I would like you to take whatever few moments you would like to respond. First, GAO does not believe that the restraints in the civilian program of the United States Government, in terms of personnel, is necessary saving the taxpayers any money. I do not have their exact report, but they have begun to audit this, and they say preliminary that what is happening, Dr. Rivlin, is that as you reduce the civilian work force, you increase the contracting out to others to do the job they were doing. And their estimate is it could very well be that reducing the personnel and contracting out has cost the taxpayers more, not less.

Have you happened to review that in your capacity? Could you shed some light on it?

Dr. RIVLIN. I cannot. We will have to look at that. But one of the things we have been trying to do in the interest of saving money is to privatize some of the Federal Government's functions, sometimes known as contracting out.

We do not privatize if it doesn't save money. We have very strict procedures that govern when you do it and when you don't. But, clearly, we have moved some functions into the private sector—a sort of Republican thing to do, I thought. [Laughter.]

Chairman DOMENICI. Well, we propose it, but we propose that we at least try to save money doing it.

Dr. RIVLIN. We do, too.

Chairman DOMENICI. There is no real genuine desire to run around and contract things out. We assumed it would be more efficient. If we are wrong, you might tell us that.

Dr. RIVLIN. No; we do it when we think it is more efficient, too. I think we are on the same wavelength on that.

[The following was subsequently submitted for the record by Dr. Rivlin:]

With enactment of the Federal Workforce Restructuring Act of 1994 (FWRA), we estimated that the required cuts in FTE employment would save over \$40 billion between fiscal year 1994 and fiscal year 1999. These were real savings that the agencies had to achieve to live within projected discretionary funding levels.

Since 1994, further constraints on discretionary funding for most agencies have forced FTE reductions below the FWRA ceilings and, thus, have produced even greater savings. In fiscal year 1995, the actual number of FTEs was 67,000 below the FWRA ceiling.

The GAO report that you cite is still in draft and we have not seen it. It is our understanding that while GAO identified two or three cases of inappropriate back-filling of vacated in-house positions with contractors, their report makes a favorable assessment of the overall downsizing effort. This should not be surprising, for several reasons.

First, as noted above, discretionary funding constraints are forcing agencies to reduce employment below the FTE levels permitted by the FWRA; the dollars are generally not available to replace Federal employees with contractors. Second, OMB Circular No. A-76 requires agencies to perform cost analyses before shifting in-house work to contractors, and the FWRA prohibits increases "in the procurement of service contracts by reason of the enactment of this Act, except in cases in which a cost comparison demonstrates such contracts to be to the financial advantage of the Federal Government." Third, there is no indication of the increase in spending

on contract services that one would expect if FTEs were being replaced with contractors. In fact, over the past 3 years there has been no real increase in funds spent on contracting out.

Chairman DOMENICI. My last one has to do with medicare, medicaid and welfare reform. Obviously, you want the CBO—the official estimator of matters for the Congress—to estimate how much you are going to save in these programs.

Dr. RIVLIN. That is right.

Chairman DOMENICI. My guess is that they cannot do that until you provide them with the specific policies upon which you predicate your savings.

Dr. RIVLIN. That is right, and we have done so.

Chairman DOMENICI. I understand we do not have your specific policies, that they are not in your budget, and——

Dr. RIVLIN. Oh, no; they are spelled out in extraordinary detail, and we also have them in legislative language if you would like to read it.

Chairman DOMENICI. But do we have them in the budget?

Dr. RIVLIN. Yes.

Chairman DOMENICI. OK. I am mistaken. Who said we did not? Oh, HHS told us you did not.

Dr. RIVLIN. Well, I do not know where they have been, but we have spelled it out very——

Chairman DOMENICI. They do work for you, however.

Dr. RIVLIN. They sometimes do. [Laughter.]

Chairman DOMENICI. OK. In any event, we sure would like to see that.

We might very well have some additional requests of you in writing.

Senator Sarbanes, do you have any questions?

Senator SARBANES. Yes; am I correct that amongst the G-7 countries, the United States now has the lowest deficit as a percentage of the gross national product?

Dr. RIVLIN. I believe that is true. I was actually just at an OECD meeting, and my colleagues at that meeting were amazed at how low our deficit is as a percent of GDP, because they all have higher ones. I am not suggesting that we should rest on our laurels, but we are doing pretty well with respect to other countries.

Senator SARBANES. Thank you.

Dr. RIVLIN. Mr. Chairman, with your indulgence, could I just say a word about the political nature of this budget?

Chairman DOMENICI. You might, but let me just make one further point. We are told again—and I would like you to take this very seriously—we are told that the legislative language for these three programs is not available to CBO nor to us. So maybe you have it, maybe it is ready——

Dr. RIVLIN. Well, we have detailed policies which we have set forth. We may not have transmitted the legislative language to you, but we are prepared to. It exists; it is this high. Lots of people have been working to make sure the legislative language is available.

Chairman DOMENICI. Could I ask on just two programs that I think are very important to success around here—welfare reform and medicaid reform. Democratic and Republican Governors have

unanimously adopted a policy—they did not write legislation, but they adopted a policy. They then reduced it to writing within the last 2 or 3 weeks. Do you know whether the Administration supports the language and legislation prepared by the Governors or not, on those two programs?

Dr. RIVLIN. With respect to welfare, I think we are pretty close. We still have some reservations about the Governors' approach, but we are very close.

With respect to medicaid, we have much graver reservations, as do the Democratic Governors themselves. I believe that proposal is much less close to final form. I think the NGA would admit that, and we have all been curious as to how much money, if any, the proposal would save. According to our reading of the bill, the formula, as originally constructed, would actually cost money, and I think CBO agrees with that.

Chairman DOMENICI. Thank you very much.

Senator Sarbanes, further questions?

Senator SARBANES. No questions, Mr. Chairman.

Chairman DOMENICI. We stand adjourned until the call of the chair. It is not the Chairman's plan to have any detailed hearings before we have markup; we will use the Administration's budget and whatever other information we have available, but we will probably from this hearing move to markup sometime after Easter recess.

We stand in recess.

[Whereupon, at 12:25 p.m., the committee was adjourned subject to call of the chair.]

OPENING STATEMENT OF CHAIRMAN PETE V. DOMENICI

Let me welcome our distinguished witness, Dr. Alice Rivlin. As you all know, Dr. Rivlin has been nominated to the Federal Reserve Board and it is likely that this is the last time she will be testifying before the committee in her current capacity as the Director of the Office of Management and Budget.

Dr. Rivlin, on behalf of the committee, I'd like to express our gratitude for your service as Director. You have a long record of service in the Federal budget arena, beginning over 20 years ago when you became the first Director of the Congressional Budget Office. We wish you well in your future endeavors at the Federal Reserve.

Yesterday, we received the details of the President's budget plan for 1997. According to OMB estimates and economic assumptions, Dr. Rivlin, this budget will reach balance in 2001. You also claim that this budget will reach balance in 2002 according to your interpretation of CBO scoring. I see nothing new here, this is what the Administration has been claiming for the past 4 months. Based on the outline submitted on February 5, CBO would probably say that this does not quite balance, although we will not get a definitive answer from CBO for several weeks.

There is nothing new in this budget in terms of controlling entitlements. Even though we have hard evidence that the Medicare Trust Fund is running a deficit now, 2 years earlier than we expected last year at this time, this budget proposes a band-aid solution that will have to be revisited in a few years. This budget sharply increases deficit reduction in 2002 to reach balance, specifically by sunsetting the tax cuts and assuming significant receipts from spectrum auctions. On the discretionary side, the President tells us what he is increasing spending for, but not what he is cutting.

I am disappointed, Dr. Rivlin, because I know you know better. Last year, in a response to a request from Senator Kerrey, you released some long-range baseline deficit projections. I've always talked about \$200 billion deficits as far as the eye can see, but according to your estimates, I was not looking ahead far enough. The deficit will double in about 15 years, and then double again every 5 years after that. By 2025, you estimated that the deficit would be almost \$2 trillion and half of that

would be attributed to the Medicare Program. This is not the kind of legacy I want to leave for our youngest generation and I know you don't either.

So, once again, I thank you for being here today and I turn now to Senator Exon for his comments.

LONG-TERM BUDGETING

The first and most significant recommendation endorsed by a majority of the Bipartisan Commission on Entitlement and Tax Reform was that the Federal Government make major spending and tax decisions with reference to a longer time period than the traditional 5 year budget window. As a result, the Senate Committee on Appropriations requested OMB to provide a 30-year analysis of the costs of the major entitlement programs. That information was submitted to the committee in a letter dated, September 12, 1995. The conferees have decided to print that letter and the accompanying document in the statement of managers so that the American public can be aware of the long-range costs facing the country as a result of entitlement programs. That information follows:

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF MANAGEMENT AND BUDGET,
Washington, DC, September 12, 1995

Hon. J. ROBERT KERREY
U.S. Senate
Washington, DC

DEAR SENATOR KERRY: In response to your interest in the long-range outlook for the Federal budget, enclosed is a table that lists long-range baseline projections. These projections extend the baseline estimates published in the Administration's Mid-Session Review of the 1996 Budget for a period of 30 years.

These projections use the best methodology and data available. However, it is very important to recognize the large uncertainties inherent in making projections of receipts and outlays this far into the future. The projections are obviously highly sensitive to the underlying economic and demographic assumptions. In addition, they rely on a simplified model of the budget. Receipts projections are based on a simplified derivation of tax bases implied by the underlying economic assumptions. Discretionary budget authority and outlays follow the caps specified in the Omnibus Budget Reconciliation Act of 1993 through fiscal year 1998 and rise at the rate of inflation thereafter. Outlays for major entitlement programs are projected using a combination of underlying economic assumptions, available actuarial data and an analysis of recent trends.

It is also important to recognize that all of the projections in the enclosure are *baseline* estimates. They do not reflect the policies in the President's balanced budget plan or in the Congressional Budget Resolution. Instead, they only project the effects of current laws assuming the policies underlying those laws are not changed.

I hope this information is helpful to you and I look forward to working with you to address both the short- and long-term fiscal problems our Nation faces.

Sincerely,

ALICE M. RIVLIN,
Director

^a Treasury Department, The United States Postal Service, The Executive Office of the President, and Certain Independent Agencies Appropriations Bill—Conference Report.

LONG-RANGE BASELINE PROJECTIONS

(in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Baseline totals:										
Receipts	1,418	1,485	1,561	1,644	1,737	1,831	1,928	2,028	2,133	2,251
Outlays	1,603	1,582	1,756	1,846	1,946	2,037	2,143	2,250	2,368	2,499
Deficit (-)	-185	-197	-194	-202	-208	-206	-216	-222	-235	-248
Memorandum:										
Discretionary budget authority	522	535	542	558	576	594	612	631	650	671
Trust fund surplus/deficit (-): ¹										
OASDI ²	75	81	87	92	98	105	112	120	127	135
HUSMI	6	-4	-9	-16	-23	-31	-40	-49	-59	-70
Civil service retirement	27	27	28	29	32	33	-34	35	36	36
Military retirement	3	2	2	1	1	0	-0	-1	-2	-2

¹ Based on most recent actuarial reports.² Figures are for calendar years.

LONG-RANGE BASELINE PROJECTIONS

(in billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Baseline totals:										
Receipts	2,363	2,485	2,611	2,742	2,878	3,020	3,167	3,320	3,477	3,639
Outlays	2,627	2,763	2,908	3,066	3,235	3,413	3,602	3,806	4,026	4,264
Deficit (-)	-264	-278	-298	-324	-357	-393	-435	-487	-549	-625
Memorandum:										
Discretionary budget authority	691	713	735	758	781	805	830	856	883	910
Trust fund surplus/deficit (-): ¹										
OASDI ²	144	152	157	159	162	164	161	154	143	128
HUSMI	-83	-97	-111	-128	-148	-170	-196	-227	-261	-299
Civil service retirement	37	37	38	38	39	39	40	40	40	41
Military	-3	-4	-5	-6	-7	-8	-8	-9	-9	-5

¹ Based on most recent actuarial reports.² Figures are for calendar years.

LONG-RANGE BASELINE PROJECTIONS

[In billions of dollars]

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Baseline totals:										
Receipts	3,807	3,985	4,167	4,355	4,552	4,755	4,967	5,188	5,413	5,650
Outlays	4,511	4,772	5,053	5,353	5,675	6,017	6,383	6,775	7,194	7,644
Deficit (-)	-704	-787	-886	-998	-1,123	-1,261	-1,416	-1,587	-1,782	-1,995
Memorandum:										
Discretionary budget authority	938	967	997	1,028	1,060	1,093	1,127	1,162	1,198	1,235
Trust fund surplus/deficit (-): ¹										
OASDI ²	108	81	49	12	-30	-78	-132	-193	-260	-334
HHS/M	-341	-389	-444	-505	-571	-644	-727	-821	-924	-1,037
Civil service retirement	42	43	44	45	46	47	49	50	52	54
Military retirement	8	11	41	46	52	59	66	74	82	92

¹ Based on most recent actual reports.² Figures are for calendar years.

PREPARED STATEMENT OF SENATOR OLYMPIA J. SNOWE

Thank you, Mr. Chairman. I'd imagine I'm not the only one here today that finds it a bit ironic that we are reviewing President Clinton's fiscal year 1997 budget proposal when we still haven't reached an agreement on the fiscal year 1996 budget! But I guess in the aftermath of a year in which we saw not one, not two, but six budget proposals by the Administration—and not one, but two Government shut-downs—we've all learned that “common sense” may have little to do with managing our Nation's ledger.

For those of us on this committee who have always been staunch supporters of a balanced budget, the current budgetary stalemate that has ensued between the Administration and the Congress is a frustrating one. Last year began with great expectations and high hopes that fiscal year 1996 would be the year that we would finally turn the tide on our rising sea of red ink, and that by year's end we would be on course toward a balanced budget in 2002. Perhaps the single greatest impetus to proving that it could be done despite the enormous odds was delivered during debate on the Balanced Budget Amendment. Long-standing opponents—or recently-converted opponents—of the Balanced Budget Amendment called for Republicans to “show us your plan!” Well, despite the fact that the Administration couldn't “show us their plan” until their fifth attempt in January 1996, over a period of 10 long months Congress crafted a balanced plan and drafted the legislative changes necessary to make it happen and delivered it to the President in November—but that plan was vetoed.

Despite the veto, many still had hope that a negotiated agreement could be reached—common sense would prevail—and a balanced budget was in the offering. Well Christmas came and went, New Year's came and went, and even Martin Luther King Day came and went—but still there was no deal between the Administration and Congress. In the meantime, a bipartisan group of Senators came together to prove that differences could be overcome, policies could be agreed upon, and the budget could be balanced without employing every back-loaded “gimmick” in the book. This group grew from a mere six members to more than 20 in a matter of weeks.

And while I'm sure that there are still items in the nearly-completed Senate Bipartisan Budget Proposal that can be singled out and opposed by any Member of Congress or by the Administration, the fact remains that it is the only bipartisan plan available, and it may well be our last, best hope for a Balanced Budget Agreement in the 104th Congress.

And unlike any other proposal to date, it is truly a compromise. Republicans and Democrats alike were forced to accept “middle ground” on issues including medicare and medicaid reform, and tax cuts. Perhaps the one aspect of the plan that the group can be most proud of is its discretionary spending number. While many pay “lip service” to protecting education or the environment, our plan makes it possible by maintaining the discretionary spending reduction at only slightly more than a “freeze” level—unlike other proposals that cut deeply into discretionary spending, particularly in the final 2 years of their plans to show a “paper balance” in 7 years.

Therefore, while I look forward to the testimony of today's witness on the President's fiscal year 1997 budget proposal—and congratulate her on her recent nomination to the Federal Reserve Board—I am particularly interested in the Administration's comments on the Senate Bipartisan Budget Proposal. To date, we have been given consistent encouragement by the Administration in our efforts to craft a bipartisan plan. However, the day is rapidly approaching when the President's support or opposition to the plan will make all the difference in its success or failure in Congress. I am hopeful that the President—who has repeatedly called for compromise on the budget and other issues—will heed his own advice and take this opportunity to embrace a truly bipartisan proposal.

Thank you, Mr. Chairman.

**WRITTEN QUESTIONS FROM SENATOR DOMENICI TO
DR. RIVLIN AND THE RESPONSES**

INTERNATIONAL AFFAIRS

1. The President's budget proposes to pay US arrearages for both the UN regular budget and the UN Peacekeeping Operations for Fiscal Years 1997 to 2001 accompanied by new language linking obligation of funds with UN reform proposals. What specific reforms does the administration propose and expect to be in place before this money is disbursed?

Answer -- The Administration has identified a series of reform items but has not proposed specific actions tied to specific fiscal year disbursements, pending further consultations with Congress on UN reform and funding. The Administration's budget proposes that there be a clear set of actions and reform measures, agreed to by the President and Congress, before any disbursements would occur.

Background

The Administration has offered important elements of a UN reform agenda at meetings of the High Level Working Group (of the UN) in February and March 1996.

The process of working through a reform agenda, negotiated with all UN Member states, is ongoing. Moreover, there is a firm commitment to develop with the Congress a tough but reasonable set of actions that are tied to these disbursements.

Among the reforms to consider, an important item is ensuring fiscal restraint in the UN. This is already beginning to happen. In December 1995, UN Members agreed to a budget for calendar years 1996/1997 which is lower in nominal terms than the 1994/1995 level. This was an unprecedented change in the U.N.

Beyond the current period, there should be a concerted effort by the US (and other Member governments) to alter the existing scale of assessments and to lower the U.S. share from 25% of the general budget costs to 20%. With regard to UN peacekeeping costs, U.S. law requires that the U.S. share be capped at 25%; however, this remains to be adopted by the UN which still assesses U.S. costs at 31%. It's important to consider that any agreement within the U.N. to alter these assessments would likely depend on an understanding that the U.S. would meet its financial obligations to the U.N., including the arrears.

Another reform worthy of consideration is extending to the various UN specialized agencies their own internal oversight (similar to the concept of inspectors general).

DEBT MANAGEMENT SAVINGS TREASURY FINANCING

Three years ago, Treasury announced that it would reduce the issuance of long term bonds. This reduced the maturity of both debt outstanding and new debt incurred. It also necessitated refinancing a larger share of the debt within a shorter period of time. OBRA-93, as scored by the Administration assumed that this debt management change would save \$16.4 billion over 5 years. Your 1997 budget assumes \$7.0 billion in savings from additional debt management changes.

1. Has Treasury actually achieved the interest savings that were estimated three years ago?

Answer -- In May, 1993, Treasury announced that (a) 7-year notes would no longer be issued and (b) 30-year bonds would be issued semiannually instead of quarterly. Treasury made additional changes from previous plans, not included in the public announcement, that further shifted away from longer maturities.

Based on CBO interest rate assumptions (used for the FY 1994 Budget), these changes were estimated to save the following amounts (\$millions):

<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>Total</u>
804	1,394	1,788	2,699	4,143	10,828

In the two years that have passed since these announcements, Treasury financing has differed in small ways from the plan, resulting in slightly higher savings than originally projected. If interest rate assumptions and deficits are kept unchanged from the FY 1994 Budget, and debt management savings were recalculated using the mix of securities (3-year and longer maturities) actually issued during FY 1994 and 1995, the savings are increased as follows:

	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>Total</u>
May, 1993 plan.....	804	1,394	1,788	2,699	4,143	10,828
Effect of actual financing.....	<u>+256</u>	<u>+192</u>	<u>+331</u>	<u>+458</u>	<u>+428</u>	<u>+1,665</u>
Revised savings.....	1,060	1,586	2,119	3,157	4,571	12,493

2. What assumptions does the budget make regarding how debt management will change? Where does the \$7.0 billion in savings come from?

Answer — The Treasury issues marketable securities on a regular, predictable schedule to refund maturing securities and raise cash. In the past when there have been reductions in Treasury borrowing needs, the Treasury has reduced issuance of short-term securities and maintained issuance of intermediate and longer-term issues. In the event of substantial reductions in deficits—over \$650 billion during the FY 1996-2002 period—the Treasury would also reduce intermediate and longer term securities from what they would have been without the deficit reduction. Lower deficits would result in reduced interest costs in any event, but these reductions would be even greater because the Treasury would reduce its borrowing in intermediate and longer term issues. The savings would not occur if the deficit reductions do not materialize.

The additional savings from a reduced reliance on intermediate and longer maturities are estimated as:

<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>Total</u>
244	851	1,523	2,224	2,130	6,972

In the baseline financing assumptions, the average remaining maturity of marketable debt held by the public would rise from 5.35 years in 1994 to 5.55 years in 2002. The shift to shorter maturities would result in a decline of the average maturity to 4.82 years in 2002.

3. Will the recent rise in short-term interest rates affect the savings that the Administration had expected from this policy?

Answer — The following table displays recent trends in short- and long-term rates:

	1993	1994	1995	March 28, 1996
13-week bills (discount)	3.02	4.27	5.51	5.03
30 year bonds (coupon)	6.60	7.37	6.88	6.70

Short-term rates have risen from depressed levels toward the end of the last recession and long-term rates have fluctuated. From the perspective of debt management savings, these changes are not particularly significant. The main change since 1993 has been the flattening of the yield curve. As the yield curve flattens, somewhat smaller savings would result from shifting to shorter maturities. (In the extreme case, where short-term and long-term rates are identical over an extended period of time, there would be no savings shifting among maturities). However, debt management savings continue to be positive and in approximately the same magnitude as shown in the Treasury's May 1993 plan and the FY 1997 Budget. Neither OMB nor Treasury attempt to measure the effect of short-term fluctuations on interest costs or debt management alternatives.

DEFENSE

1. Why did OMB instruct DOD to use the obsolete -- based on a 1987 basket -- implicit GDP deflator for DOD, while the new -- more generally accepted -- chain-weight deflator is used only for the Administration's economic projections?

Answer -- The Administration did not have the necessary data, and the corresponding new economic models, in time to develop the economic assumptions for the budget on the chain-weighted basis. The assumptions distributed to all agencies--DoD and civilian--were based on the fixed-weighted methods. The Administration translated the assumptions into chain-weighted terms after the fact, to reduce confusion for those who would later compare the Budget's economic assumptions with subsequent releases of GDP data from the Commerce Department.

2. What would be the size of DoD's inflation "savings" in FY 1996 and for the 1997-2002 FYDP if the newer chain weight deflator were used for the calculations? Is it correct that the "savings" would be substantially smaller and that the Administration's problem of underfunding the DoD budget would be that much greater?

Answer--The fixed-weighted deflator was used, exactly as it has been in past budgets, to compute the inflation savings in the nonpay portion of the defense program. The calculation was based on the change in the growth rates in the fixed-weighted deflator assumed in the 1997 Budget versus those assumed in the 1996 Budget. The 1996 Budget assumptions did not include a projection for the chain-weighted deflator, and the 1997 Budget assumptions were based on the fixed-weight deflator (and made a chain-weighted estimate only after the fact). In addition, DoD developed its detailed estimates for the budget on a fixed-weighted basis. Based on data now available, the inflation savings would have been smaller if computed on a chain-weighted basis, but such a calculation is somewhat uncertain for the reasons noted.

Regardless of the basis for calculating the inflation savings, the Administration's defense budget is not underfunded. Even if the change in inflation had been calculated using the chain-weighted deflator, the President's 1997 Budget for DoD would still provide more purchasing power than did the 1996 Budget.

TREATMENT OF CIVILIAN PROCUREMENT

1. What amount of inflation savings has been found in civilian agency procurement accounts for FY 1996 and in the future? (E.g. NASA, GSA, DoT, FAA, etc.; we believe none was declared.) If none, why is DoD procurement being handled differently from the civilian agencies? Why is this fat being left in the civilian agency budgets?

Answer--The President's budget proposal holds discretionary funding for civilian agencies well below the rate of inflation. Rather than leaving "fat," the President's budget proposes outyear funding that is below the 1997 level for each of the agencies cited.

Civilian agency budgets have always been treated differently than the DoD budget. No civilian agency buys as much long-term hardware on long-term contracts as does DoD, and no civilian agency's budget is (or has been) estimated in a way comparable to DoD. For DoD, the Administration estimated the outyear cost of the nonpay portion of the defense program, based on changes in inflation in the GDP deflator, exactly as it has in past budgets. As noted above, the 1997 Budget proposal for DoD provides an increase in purchasing power over that proposed in the 1996 Budget. Because funding for the civilian agencies cited is cut in nominal terms (and cut even deeper in real terms), these agencies would actually have less purchasing power than proposed in the 1996 Budget.

DOD INFLATION MONEY AND THE FIREWALL

1. Of the \$45.7 billion inflation savings declared in the DOD FYDP, \$15.2 billion was returned to the Treasury for spending in other budget functions. Does this mean, in effect, that this \$15.2 billion is being sent over the firewall that was intended to prevent the transfer of defense funds to civilian spending?

Answer -- The savings did not go toward other budget functions. Overall, in fact, nondefense discretionary programs sustained much larger reductions than the \$15.2 billion in defense inflation savings. Rather than being used for other functions, the defense savings contributed toward the overall discretionary savings in the Administration's deficit reduction targets.

OMB'S INFLATION ESTIMATES

1. Unlike civilian procurement accounts, the DoD procurement account is planned six years into the future. However, it is difficult, if not impossible, to predict accurately inflation this far into the future. Has inflation ever remained as low as you are projecting in the DoD procurement budget for as long as you are projecting?

Answer -- The last time that the implicit GDP deflator grew at an annual rate of 2.2% or less for such a prolonged period was in the early 1960s. This is the case whether the deflator is measured on a fixed-weighted or chain-weighted basis. Recent data provide evidence that the

economy is once again positioned for a period of sustained low inflation. Inflation in the fixed-weight GDP deflator in the eight quarters prior to shifting to the chain-weighted measure was 1.8% at an annual rate. Over the same period, the change in the new chain-weighted deflator was 2.4%.

It should also be noted that inflation in defense investment has often been less than overall inflation in GDP. Growth in the deflator for defense durables and other investment (chain-weighted basis) has been less than 2.2% for seven of the last ten years.

2. If actual inflation exceeds your projections for the future, will Congress need to appropriate additional funds to cover the cost of the "unanticipated" inflation?

Answer -- While the President's budget proposes a multi-year plan for defense appropriations, the actual appropriations are only enacted one year at a time. In its future budgets, as it has over the past three years, the Administration will revise its proposed long-range defense plan as necessary to meet defense needs.

3. Would you agree that by reducing the projections for inflation five and six years from now the Administration is reducing an important margin of safety in its future projections of defense spending?

Answer -- No. The Administration's budget contains the resources needed to fully support high levels of military readiness and the quality of life of our military forces, while providing for planned force modernization. By partially adjusting the defense "top line" for inflation, the real value of the President's defense program is retained, but at lower nominal dollar levels.

4. Which is the more prudent, conservative approach for projecting inflation six years from now: lower estimates of future inflation or slightly higher ones?

Answer -- The most prudent approach to budgeting is to use the most accurate projections possible. The inflation rate has been falling, broadly speaking, for 15 years, and the fundamental factors keeping it in check appear well entrenched. The 2.2% growth rate assumed for the fixed-weight deflator is quite reasonable, especially in light of its historical growth rate of 1.8% in the previous eight quarters. Furthermore, as both CBO and OMB estimates document, changes in inflation have very little net effect on the deficit. While higher inflation would increase outlays, it would also increase receipts because of a larger nominal tax base.

DOD DEFLATOR

1. For FY 1997, the Administration is asking for a 3 percent military pay raise. Why is the Administration using a deflator for military pay different from the deflator for DOD procurement and different from the Administration's macroeconomic projections?

Answer -- The proposed military pay raise was not based on a deflator. It was based, as it has been in past budgets, on the need to continue to attract and retain a highly qualified defense force. This is in contrast to the GDP deflator, which is the economic measure traditionally used to determine the real purchasing power of the nonpay portion of the defense program.

NOMENCLATURE

1. Why is this money being called a "savings?" (The only thing done to "save" it was to change estimates for inflation.)

Answer -- The lower estimates of defense spending relative to last year's budget contribute to the Administration's overall \$185.7 billion in savings from the discretionary baseline. Some might prefer a term other than "savings" to describe this reduction in outlays from the baseline; for example, "cost reduction." Increased spending attributable to higher inflation is usually referred to as a "cost increase."

FEDERAL R&D SPENDING

Ms. Rivlin, the President's budget proposes \$14 billion for basic research, an increase of \$278 million over 1996, and goes on to state that basic research at the National Science Foundation and National Institutes of Health both receive a four percent increase. (1) If this is true, then what agencies have received reductions in basic research in 1997 in order to fully fund the President's basic research for NSF and NIH? (2) I would like to request that OMB prepare a table showing by agency, increases and/or decreases for basic, applied, development, equipment and facilities funding in the President's proposed budget.

Answer -- The increase in funding for NSF and NIH was achieved, within the overall discretionary spending constraints, by reducing many other accounts across the government -- both R&D and non-R&D.

Table 10-1 in the budget displays research and development investments. The additional agency-by-agency detail which has been requested is attached.

RESEARCH AND DEVELOPMENT INVESTMENTS					
(Budget authority, dollar amounts in millions)				Dollar	Percent
				Change	Change
	1995	1996	1997	1996 to	1996 to
BASIC	Actual	Estimate	Proposed	1997	1997
HHS	6,072	6,446	6,563	117	2%
NASA	1,968	1,869	1,826	-43	-2%
NSF	1,964	2,027	2,116	89	4%
DOE	1,621	1,609	1,637	28	2%
DOD	1,176	1,119	1,156	37	3%
USDA	600	590	615	25	4%
SMITH	131	132	144	12	9%
DOI	79	72	57	-15	-21%
EPA	70	69	75	6	9%
DOT	36	39	45	6	15%
DOC	35	37	38	1	3%
VA	16	17	17	0	0%
LABOR	14	14	14	0	0%
JUSTICE	9	8	12	4	50%
ED	8	6	8	2	33%
CORPS	3	3	3	0	0%
TVA	3	1	1	0	0%
AID	0	1	0	-1	-100%
TOTAL	13,805	14,059	14,327	268	2%

RESEARCH AND DEVELOPMENT INVESTMENTS					
(Budget authority, dollar amounts in millions)				Dollar	Percent
				Change	Change
	1995	1996	1997	1996 to	1996 to
APPLIED	Actual	Estimate	Proposed	1997	1997
HHS	3,989	4,107	4,216	109	3%
DOD	2,933	2,755	2,698	-57	-2%
NASA	1,923	2,147	2,312	165	8%
DOE	1,783	1,887	2,071	184	10%
DOC	780	773	840	67	9%
USDA	720	697	687	-10	-1%
DOI	538	504	482	-22	-4%
EPA	330	287	335	48	17%
DOT	301	275	332	57	21%
AID	226	155	161	6	4%
VA	215	219	219	0	0%
NSF	173	177	189	12	7%
ED	126	86	135	49	57%
NRC	89	59	59	0	0%
HUD	42	34	45	11	32%
SOCSEC	33	14	14	0	0%
CORPS	20	21	20	-1	-5%
JUSTICE	19	18	22	4	22%
TVA	16	9	8	-1	-11%
LABOR	8	7	9	2	29%
FAP	5	14	14	0	0%
TREASURY	2	3	2	-1	-33%
ACDA	1	1	1	0	0%
MMC	1	1	1	0	0%
TOTAL	14,273	14,250	14,872	622	4%

RESEARCH AND DEVELOPMENT INVESTMENTS					
(Budget authority, dollar amounts in millions)				Dollar	Percent
				Change	Change
	1995	1996	1997	1996 to	1996 to
DEVELOPMENT	Actual	Estimate	Proposed	1997	1997
DOD	30,869	31,181	31,297	116	0%
NASA	5,161	4,952	4,896	-56	-1%
DOE	2,289	2,371	1,678	-693	-29%
HHS	1,386	1,396	1,420	24	2%
DOT	300	266	279	13	5%
DOC	224	207	228	21	10%
EPA	149	167	170	3	2%
USDA	68	70	71	1	1%
TVA	60	55	68	13	24%
POSTAL	52	67	71	4	6%
DOI	45	37	29	-8	-22%
CORPS	37	22	22	0	0%
ED	35	24	39	15	63%
FAP	29	8	8	0	0%
AID	27	19	20	1	5%
VA	26	27	26	-1	-4%
JUSTICE	21	16	23	7	44%
LABOR	19	13	15	2	15%
TREASURY	9	11	9	-2	-18%
NASA ALLOWANCE	0	0	342	342	NA
TOTAL	40,806	40,909	40,711	-198	-0%

RESEARCH AND DEVELOPMENT INVESTMENTS					
(Budget authority, dollar amounts in millions)				Dollar	Percent
				Change	Change
	1995	1996	1997	1996 to	1996 to
FACILITIES	Actual	Estimate	Proposed	1997	1997
DOE	476	489	551	62	13%
HHS	72	169	422	253	150%
DOE ALLOWANCE	0	0	216	216	NA
NASA	150	177	155	-22	-12%
DOC	115	61	142	81	133%
USDA	154	122	126	4	3%
DOD	57	45	41	-4	-9%
NSF	61	55	32	-23	-42%
DOT	30	42	23	-19	-45%
DOI	6	9	14	5	56%
JUSTICE	0	0	7	7	NA
VA	6	3	5	2	67%
EPA	5	5	5	0	0%
SMITH	3	3	3	0	0%
ED	5	21	0	-21	-100%
TOTAL	1,140	1,201	1,742	541	45%

RESEARCH AND DEVELOPMENT INVESTMENTS					
(Budget authority, dollar amounts in millions)				Dollar	Percent
				Change	Change
	1995	1996	1997	1996 to	1996 to
EQUIPMENT	Actual	Estimate	Proposed	1997	1997
DOD	314	329	330	1	0%
DOE	312	333	332	-1	-0%
NSF	233	171	179	8	5%
NASA	188	189	170	-19	-10%
DOC	10	8	12	4	50%
HUD	0	0	3	3	NA
TOTAL	1,057	1,030	1,026	-4	-0%

Ms. Rivlin, the President's budget proposes \$1.4 billion for "Full Funding Allowance for Fixed Assets", which provides budget authority for acquisitions and equipment. This is the first time this request has been made by the Administration.

1. Why did OMB decide to show this as a separate request, in addition to an agency's 1997 request?

Answer -- Including this budget authority within the parent account for the projects would have created an unusually large year-to-year increase or "spike" in funding for these assets. Showing it separately makes clear that it is for fixed assets that would otherwise have been funded incrementally in later years, with all of the problems associated with incremental funding. Enacting and transferring this budget authority to the parent account will allow planning to proceed in an orderly way and help the agency keep within schedule and within cost estimates.

This method of requesting the additional budget authority is proposed only for this transition year.

2. Why does OMB only show budget authority and not outlays from this request in the Analytical Perspectives?

Answer -- Outlays are already included in the parent account. Enacting the \$1.4 billion in budget authority and transferring it to the parent accounts will not increase outlays above those already estimated for the parent accounts.

**WRITTEN QUESTIONS FROM SENATOR MURRAY TO
DR. RIVLIN AND THE RESPONSES**

Education: Dr. Rivlin, I know the President's budget proposal cuts discretionary spending by \$297 billion through 2002. How does this figure impact the Administration's efforts to fund higher education financial aid, Chapter I and job training programs? How will these investments change if the discretionary caps are forced to be lowered due to changes in the CBO deficit projections?

Answer -- The 1997 budget saves \$297 billion (using CBO's economic and technical assumptions) by cutting discretionary spending steadily from 1998 through 2002, helping to reach balance in 2002. However, the budget protects the President's investment priorities in education and training, children's programs, the environment, technology and research, and law enforcement, by projecting that most of the programs in these areas will grow by inflation from 1998 through 2002. Specific policies for key Education and job training programs are:

- o the Pell Grant program will grow by 3 percent a year, to fund a maximum award of \$3,128 in FY 2002;
- o the Campus Work Study program will increase dramatically, to increase the number of students served annually from 700,000 to one million by FY 2001;
- o continued increases for funding for Title I, Education for the Disadvantaged; and
- o annual increases through 2002 in job training programs overall, including Dislocated Worker Assistance, Summer Jobs for Youth, and Grants to States for Adult and Youth training.

These discretionary funds for education and training complement the financial assistance made available under the mandatory student loan programs, which provide degree-seeking students with universal access to postsecondary education.

We do not expect the President's commitment to these priorities to be affected by changes in CBO deficit projections.

Medicaid: The President's medicaid proposal cuts \$59.1 billion and looks very similar to his January proposal. But, can you tell us what growth rate your budget assumes to get to that level of savings? [current medical inflation is 7%] And does this proposal include a differential formula for each state?

Answer -- The President's Medicaid proposal in the FY 1997 Budget is estimated to save \$59 billion, scored off of the December 1995 CBO baseline. Medicaid savings are a result of two proposals: limiting the growth in federal Medicaid spending per person (saves approximately \$37 billion over seven years), and reducing and retargeting federal disproportionate share hospitals payments (saves approximately \$22 billion over seven years).

The Medicaid per capita cap policy sets, for each state, a federal spending “cap” per beneficiary, which adapts automatically to the size and type of each state’s Medicaid beneficiary population. The cap would limit per beneficiary spending growth to a specified index. This index is based on a five-year rolling average of historical growth in nominal GDP per capita, adjusted with a plus or minus factor to meet budgetary targets. Under CBO’s December 1995 baseline and assumptions, the average annual growth of the index would equal approximately 4.6 percent over seven years.

The President’s policy produces a seven-year average annual aggregate Medicaid growth rate of 7.4 percent, compared to CBO’s estimate of 10 percent growth in their December 1995 baseline. The seven year average annual per capita growth rate resulting from the President’s policy equals 4.2 percent, compared to CBO’s estimate of 6.9 percent per capita growth in their December 1995 baseline.

The President’s policy would establish a two-year commission to study the need for, and methods for, changing federal Medicaid matching payments to the states to better reflect the differing effects of demographics, health care utilization, and economic variation. The commission would be expected to examine the feasibility of differential growth rates for states, and would submit recommendations to the Secretary of Health and Human Services and the Congress two years after its first meeting. At that time, the per capita cap policy could be changed to reflect the commission’s recommendations for differential growth rates.

Taxes: I see that in the small business tax relief section, there is what appears to be a new tax change relating to expansion of the estate tax extension provision for closely held businesses. Can you explain briefly what this provision does and how it might benefit a small business or family-owned farm?

Answer — This provision helps small family-owned businesses and farms by providing relief from the burden of estate taxes. It makes it easier for a family to keep their business or farm in the family, if they so choose. It also simplifies the tax law. It does so by raising the size of business eligible for installment payment of estate tax, and a special reduced interest rate of 4 percent, from \$1 million of business value to \$2.5 million. It reduces the interest rate by 50 percent or more in exchange for making the interest payments nondeductible. It also makes more businesses eligible by eliminating distinctions based on the form of ownership.

Welfare Reform: Dr. Rivlin, the President has attached \$40 billion in savings through welfare reform. Can you lay out how your welfare reform plan differs from some of the Republican proposals, specifically, what are some of the differences in the Supplemental Security Income program?

Answer — The Administration remains firmly committed to welfare reform. The President's FY97 budget includes a comprehensive proposal that would dramatically change and improve several programs. Key features of the proposal, and differences with the conference report on HR 4 (vetoed by the President last January) and the recent proposal from the National Governors Association, include the following:

SUPPLEMENTAL SECURITY INCOME

The Administration's proposal would tighten eligibility for the SSI program for childhood disability, while maintaining eligibility for full cash benefits for children determined to be severely disabled enough to qualify for benefits. For new applicants, tightened eligibility requirements would be effective upon enactment. Children currently on the rolls found no longer eligible would not begin to lose benefits until January 1, 1998.

H.R. 4 would also tighten eligibility for the SSI program for childhood disability. In addition, however, H.R. 4 would create two categories of eligibility and cash benefits would be cut by 25% for three-quarters of the children coming on the rolls by creating two categories of disability. For new applicants, tightened eligibility requirements would be effective upon enactment, as would the new two-tiered eligibility system. Children currently on the rolls found no longer eligible would begin to lose benefits in January 1997.

The NGA proposal for SSI childhood disability follows the Administration's proposals in all aspects except for one. Under the NGA proposal, tightened eligibility requirements would not begin to apply to new applicants until January 1, 1998.

Both H.R. 4 and the NGA proposal have two provisions not included in the Administration's proposal. H.R. 4 and the NGA bill each include a provision to repeal the maintenance of effort requirements applicable to State programs for supplementation of SSI benefits. In addition, H.R. 4 and the NGA bill each include a provision to link the age of eligibility for SSI benefits to the normal retirement age for social security benefits, such that in the future when the normal retirement age increases so would the age of eligibility for SSI benefits.

AFDC AND RELATED PROGRAMS

The FY97 budget would replace AFDC with a work-based, time-limited Temporary Employment Assistance program with vast State flexibility, funding responsive to economic changes, and mandatory vouchers for children who reach the time-limit. Child care programs are converted into a matching block grant at \$4 billion above CBO December baseline. AFDC administration, emergency assistance, and work programs are merged into a new Work First

program, with a separate work program performance bonus fund. Transitional Medicaid is reauthorized and made permanent. Child support is strengthened. Current law child protection programs are maintained.

HR 4 would convert AFDC, work, and child care programs into block grants to States. The proposal, however, contains weak State maintenance of effort requirements, insufficient countercyclical funding, inadequate funding for child care and work, and no protections for the fair and equitable treatment of individuals. Categorical Medicaid eligibility for AFDC recipients would be ended. Four open-ended child protection programs for services, training, and administration are capped and block granted.

The NGA proposal would make several changes to HR 4. Additional funds are provided for countercyclical response, child care, and job placement performance bonuses. States are given more flexibility to meet the work requirements and to set family caps. Provisions regarding maintenance of effort, protections for individuals, and vouchers for children remain weak.

FOOD STAMPS

The FY97 budget would maintain the national nutritional safety net -- no block grants and no Food Stamp spending cap. States would be given unprecedented flexibility to coordinate Food Stamps and AFDC. States would not be permitted to deny assistance to childless families without offering a work slot (unlike HR 4). The OBRA '93 shelter deduction would continue to phase in for families with high shelter costs.

The conference report on HR 4 would undermine this universal Federal safety net program by proposing an optional food stamp block grant and imposing a cap on annual food stamp expenditures. The proposal would require States to terminate benefits to childless participants after 4 months unless the State offered the individual a workfare or training slot, would eliminate OBRA '93 expansions to the poorest families with high shelter costs, and provides flexibility to States at the expense of recipients. In addition, the proposal simply cuts the food stamp program by too much.

The National Governors' Association maintains the optional food stamp block grant and time limits proposed in HR 4, but lifts the cap on annual food stamp expenditures and maintains the OBRA '93 expansions for families with high shelter costs. The cuts to the food stamp program are still too deep.

CHILD NUTRITION

The FY97 budget would maintain national quality standards for school lunch and breakfast. The proposal would better target meal subsidies to family day care homes, and make other minor changes including rounding down all meal reimbursements to the nearest cent. (Under current law, meal reimbursements are rounded to the nearest quarter cent.)

HR 4 would allow the creation of up to seven State School Lunch and Breakfast block grant demonstrations. National nutrition standards would be compromised, especially under the block grants. And while the block grants are indexed to inflation and enrollment, they cannot adjust to changing economic circumstances. Reduced funding could lead some schools to drop the program, thereby ending access of some low-income children to free and reduced meals. In addition, the HR 4 proposal to means test family day care homes, while similar to the Administration's proposal, sets rates that are too low for homes that are not located in poor areas (\$0.90 per lunch versus \$1.00 per lunch under the Administration proposal). The lower rate may cause a substantial number of homes to drop out of the program, leading to poorer meal quality for children in these homes. The lower rate also decreases the incentive for homes to be licensed, which may lower overall child care standards.

The National Governors' Association drops the State School Lunch and Breakfast block grant demonstrations, but retains the HR 4 rates for family day care homes that are not located in poor areas.

IMMIGRANTS

Under the Administration's proposal, sponsors of immigrants would be made more responsible for those they bring into the country. If a sponsored immigrant applies for AFDC, SSI, or Food Stamps, the sponsor's income would be deemed available to them until citizenship, with exemptions for the disabled, those over 75, and selected other groups.

Under HR 4, virtually all legal immigrants would be categorically banned from receiving any kind of Federal and many State benefits. This includes those who suffer a disabling impairment, children, those currently receiving benefits, and the very elderly. State and local service providers would be required to document and verify the citizenship or alienage of nearly every individual who participates in their programs regardless of the cost or consequences.

The National Governors' Association made no recommendations concerning benefits for immigrants.

As indicated above (written question #1 submitted by Senator Domenici), the Administration has offered important elements of a UN reform agenda at meetings of the High Level Working Group (of the UN) in February and March 1996. The US proposal follows:

THE ECONOMIC OUTLOOK FOR FISCAL YEARS 1997-2006

THURSDAY, APRIL 18, 1996

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to notice, at 10:05 a.m., in room SD-608, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Grassley, Gorton, Snowe, Grams, Exon, Hollings, Lautenberg, Simon, Conrad, Dodd, Boxer, Murray, and Wyden.

Staff present: G. William Hoagland, staff director; Cheri Reidy, senior analyst for budget review; and Amy Smith, chief economist.

For the minority: William G. Dauster, democratic chief of staff and chief counsel; and Jim Klumpner, chief economist.

OPENING STATEMENT OF CHAIRMAN DOMENICI

Chairman DOMENICI. The committee will come to order, please.

We are going to start the hearing. Probably a few Senators from each side will arrive and want to be heard. I have conferred with Senator Exon, and I think what we are going to do (so as to get the witness' testimony before us at the earliest possible time) is the Chairman and ranking member will give brief opening statements, and then each member can choose to give part opening statement and part questions when their turn comes in terms of questioning. That may get us through with everybody having more of a chance at questioning.

Thank you very much, Dr. O'Neill, for joining us today and giving us your assessment and evaluation of the President's budget. We welcome your testimony on the 1997 budget resolution.

While we start today with a deficit lower than those of the early 1990's, I remain troubled by the fact that very little of this reduction has come from spending restraint. Instead, the bulk of the decline has come from passage of the thrift crisis, the economic cycle expansion, and the 1993 tax hike. In my opinion, these factors cannot be relied upon to deliver further deficit reduction down the road. Real spending restraint was not seen until this past winter when Congress sought to control discretionary spending for the current fiscal year. This was the main reason that CBO has revised its December 1996 deficit reduction of \$172 billion down to \$144 billion.

Despite the veto of the multi-year balanced budget plan, Congress was able through fiscally responsible actions on appropria-

tions to get this deficit down. However, we can't rely upon just that kind of deficit reduction for the next 5 to 7 years. We have to get reductions in other programs. Without a multi-year commitment where laws have been changed that are permanently changed, it seems to me that we are not going to have any real progress, and complacency will be the order of the day. I hope before we are finished with this year's work we can get that out of the way and get on with doing something significant with long-term implications.

Senator Exon, the CBO baseline with discretionary caps and current policy economics, as I view it, shows the deficit widening back out to \$285 billion by 2002 if no action is taken, and this assumes that we have another 6 years of economic growth with no intervening recessions. If we assume discretionary spending is frozen at the 1996 levels, the 2002 deficit baseline comes down to \$178 billion. This still leaves a very hefty figure which must be eliminated, as I see it, with meaningful entitlement reform.

There is an important point that I would like to make at this time. I caution my colleagues against using the term "baseline" to describe CBO's projections, which are based on post-policy or balanced budget economic assumptions. The term "baseline" refers to budget estimates that would result from continuing current policy through a period covered by the budget. It is a policy-neutral benchmark which is there to serve as a warning of future problems, either for fiscal policy as a whole or for individual programs.

Projections based upon the balanced budget economics are not baseline or steady-state estimates. Use of a balanced budget set of economics is only justified if those projects are the result of a credible, meaningful plan that gets us to balance. This means a willingness to tackle entitlements. Even assuming a balanced budget economics and a freeze in the 1996 discretionary account, about \$106 billion must be trimmed to achieve balance by 2002.

Dr. O'Neill, we welcome your comments on the sustainability of any deficit-cutting efforts which fails to address entitlements and of the possible consequences of such inaction on future standards of living for the American people. I think this last point is critical. Deficit reduction is not a goal in and of itself. It is obvious that it has to be important for other reasons. I believe it is the best way of enhancing U.S. productivity, boosting wages for all our citizens. It is only by freeing up domestic savings to produce private investment that the economy can grow at a faster trend level and generate higher standards of living.

While some may criticize the Federal Reserve for the present slow pace of U.S. growth, the solution to this problem rests in our hands, in Congress' hands. We have to stop directing an ever-increasing share of money towards entitlements and redirect it back to our citizens so they can invest it themselves, both private business and individuals.

I look forward to your testimony, and we will have some questions, some specific questions of you when you are finished.

I yield now to Senator Exon.

OPENING STATEMENT OF SENATOR EXON

Senator EXON. Mr. Chairman, thank you very much.

Dr. O'Neill, I want to first welcome you here today. It is always good to see you, and just as an aside, I wish to thank you for the consideration that you have given this member on a whole series of questions that I have asked you and your department. I haven't always agreed with your conclusions, but at least—

Dr. O'NEILL. Nobody ever does.

Senator EXON [continuing]. At least I think that the information that you give me is based on what you feel is right—and I guess that is all we can ask, all that I have ever asked of the many talented people that preceded you with your talents in this position. So thank you for being with us this morning, and we are looking forward to this.

I want to take a look forward to the hearing, if I might, Mr. Chairman, and I have reviewed briefly what the Congressional Budget Office will present in their new Economic and budget Outlook. Director O'Neill will deliver at least three—and I emphasize at least three—pieces of good news today. I am not sure, however, that we will not be spared the usual partisan squabbling over who should take credit for all of this. I would hope that this is good news, this is honest news; and whoever gets credit for it, I think that while we have a long way to go, we have accomplished a great deal that has not been given the attention that it should.

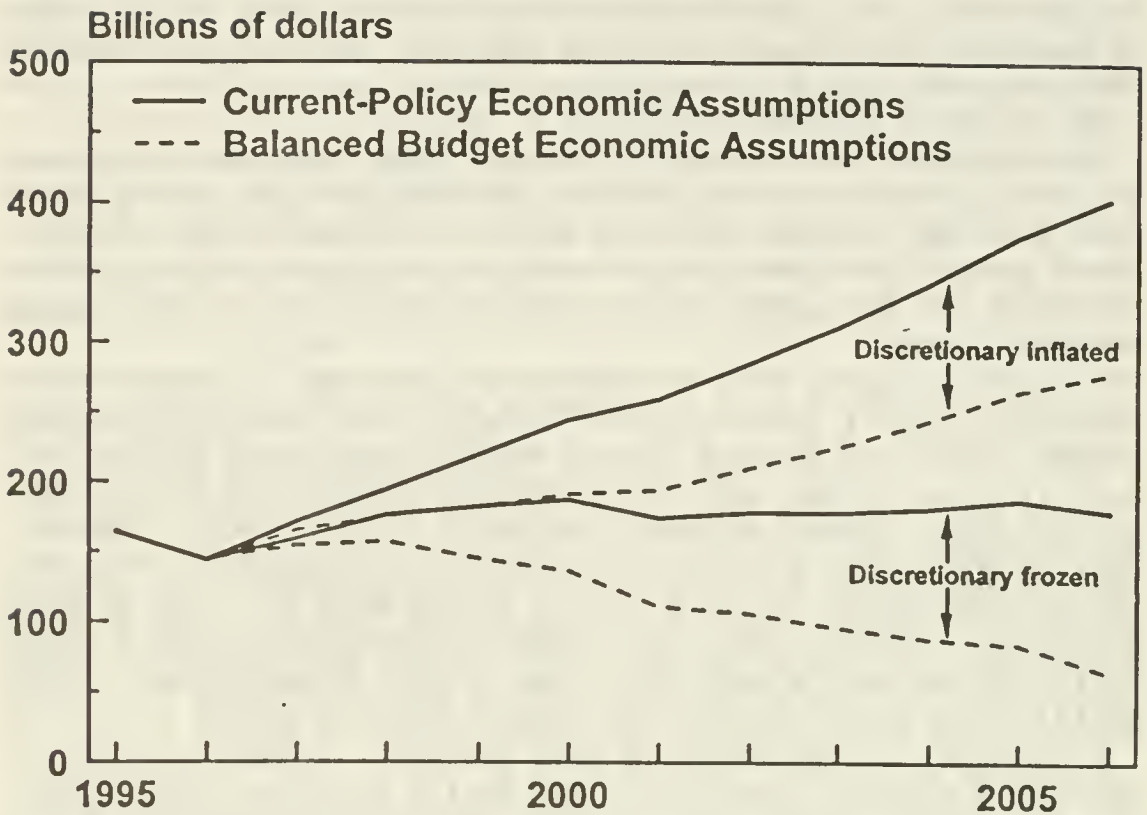
First, the economy is sound, and the CBO projections that the chances of a major turndown in the next 2 years are slim, indeed. The economy has created nearly 8.5 million new jobs since President Clinton took office, 93 percent of them in the private sector. CBO projects that unemployment and inflation will change very little from their current low levels. That is certainly good news for everyone all around, although we need to do even more to create more highly skilled, high-wage jobs that the Chairman has indicated in his opening remarks this morning.

Second, the Congressional Budget Office confirms—I repeat, the second important good news is that CBO confirms the record of deficit reduction that we have accomplished in the last few years. CBO projects that the deficit will decline this year for the fourth year in a row. This has not happened since we wound down World War II. For 1996, the deficit will tumble to \$144 billion, \$32 billion less than what CBO predicted just last December, \$66 billion less than what CBO projected a year ago, and fully \$143 billion less than what the CBO projected for 1996 when President Clinton took office.

President Clinton promised to cut the deficit in half, and the CBO confirms that he has delivered on that.

I would just like to refer for a moment, if I might, Mr. Chairman, to the chart that is entitled "Budget Deficit, CBO Estimates" that I have just referred to. This chart here compares today's numbers with those CBO presented just over 3 years ago. And if you will look at the chart, you will see this chart shows the dramatic progress that we have made, and I think both Democrats and Republicans can share in taking some degree of the credit.

CBO Deficit Projections



This has all happened since the Clinton administration took office. What the chart shows basically is that the CBO projections before Clinton, indicated by the dotted red line, are what would have happened had we continued under the previous manner of not balancing budget. And yet with President Clinton you see the level has dropped, and the CBO is projecting today, by the dotted red line, that it is going to go on down. So that is good news.

My Republican colleagues will probably try to claim that much of the improved deficit is in the forecast. But the truth is that this is unparalleled decline in the deficit, and it is due primarily to the 1993 deficit reduction bill which we passed without a single Republican vote.

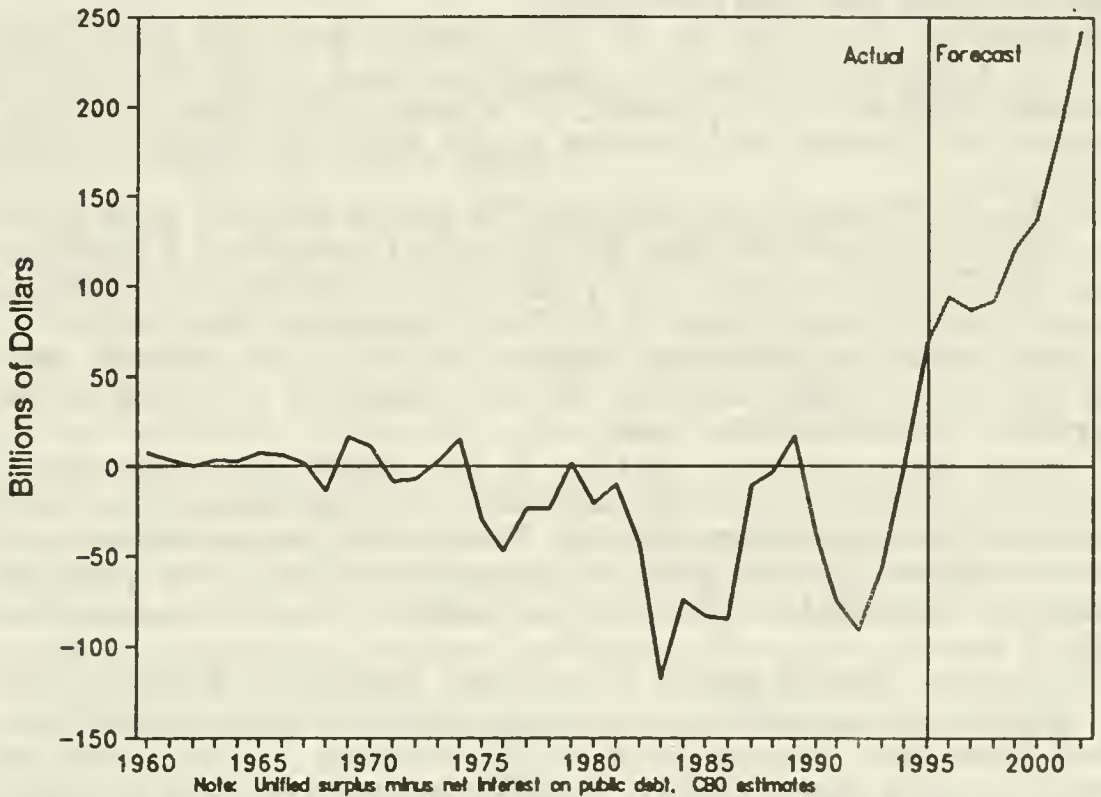
I give the Republicans some of the credit, but the facts of the matter are—and politics is alive today by the fact of “the biggest tax increase in history”, and so forth and so on. The facts of the matter are without that, without the leadership of the President, we would be nowhere near where we are today.

Even the headway that we have made since CBO’s December projection is mostly a direct result of the spending caps that the Democrats enacted in 1993 and the robust economy of the Clinton years that have followed.

As my second chart shows—and I would like the second chart to come up at this time. As this second chart shows, we are already spending less, significantly less each year on Government programs than what we collect in revenues. Another way of saying that is if we didn’t have the interest to worry about over the last many, many years of continuing to drive up the National debt from under a trillion to now over \$5 trillion, if we didn’t have that, we would

be in balance. Each year on the Government programs, though, that this chart emphasizes is that we are now, as the solid red line shows, we are now in balance as far as outgo and income is concerned, save for the tremendous crush of paying the interest on the National debt.

Revenues Exceed Program Spending



This relationship is what, as I understand it, economists call "the primary deficit." It is the healthiest that it has been in some 30 years. The fact that we have finally reached a place, at least save for the interest on the debt, we are matching and exceeding outgo with income.

The President set us on this flight path that brought us to this point, and I thank him. We know, however, that our journey is far from over. We are heading in the right direction, and we must continue on that path.

The third piece of good news that CBO will deliver today is that CBO is formally certifying that the President's new budget will achieve balance. You can see this in my first chart that I referred to earlier. I quote from page 21 of Director O'Neill's prepared statement: "The President's budget proposes policies that CBO estimates would balance the budget by 2002." I suggest that this is the first time we have ever had anything like this from a President of the United States for as long as any of us can remember.

That is no surprise to me, but I was hoping that the Chairman could find another one of those big CBO certification ribbons so that we could place it on the President's budget, too. Certainly I would tell you that for the first time since I can remember, the President's budget, which has been certified to as being in balance by the year 2002, it is the first time that I can remember that a

President's budget, Democrat or Republican, has not been basically dead on arrival when it reached the Congress. So it is a honest one.

What the CBO doesn't say is that we could already have locked into place new policies that would have balanced the budget by the year 2002, but so far we have not done so. We could have done so if the Republican majority hadn't squandered the entire year with an extremist budget that the American people couldn't support. Instead of ratcheting down the deficit, they shut down the Government time and time and time again.

Regardless, there can be no more excuses from the other side that the CBO certification is a stumbling block to the President's balanced budget. It is apparent, as it always has been, that the question of priorities and fairness to the American people is most important.

We hear, of course, that next week or maybe the next week after that the committee will mark up the budget resolution. I have not seen the Chairman's mark, but I would not be surprised if it bears a great deal of resemblance to the final Republican offer in the bipartisan budget negotiations. Those on this side will have to wait and see, and I pledge that we will be responsible in trying to cooperate as we always have been.

I would hope, however, that we do not repeat last year's futile experience when the majority ran the resolution through the committee with no input from this side. The country can do without yet another hollow partisan gesture that attempts to tip the political scales but does little to balance the budget. The stakes are very high.

As Director O'Neill makes clear in her testimony, if we balance the budget, interest rates will go down and the economy will go up. I look forward to hearing the new CBO forecast. I think it will be good news, and there is much of which we can be proud. But our accomplishments will be short-lived if we do not build on what we have accomplished in the past.

Let us not miss the opportunity again. The country expects better.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator Exon.

Dr. O'Neill, would you proceed? Your testimony will be made a part of the record. You proceed as you feel most comfortable. If you want to read it, fine. If you want to excerpt it, fine.

STATEMENT OF JUNE E. O'NEILL, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. O'NEILL. I will only touch on the highlights. My testimony, however, does cover a lot of ground: the economic and budget outlook for 1996 and for the next decade, CBO's analysis of the President's recent budget submission, and, for the first time, a look beyond the usual budget horizon at the long-run implications of current budget policies.

Those topics are discussed in some detail in my prepared statement and in considerably more detail in our annual report, which will be published next month. As I mentioned, I will only touch on the highlights, and I would like to add that it is a pleasure for me to be here today, the start of the new budget season.

The basic message of our report starts with the good news that the budget deficit is likely to be substantially lower in 1996 than it has been in recent years. However, the good budget numbers for 1996 should not be taken as reason for complacency. If no further action is taken to reduce the deficit, rapid growth in spending for medicare and medicaid will steadily push up the deficit over the next decade. Moreover, as the baby boomers begin to retire, the rise in the deficit will accelerate sharply, with potentially——

Chairman DOMENICI. Would you pull the mike up a little closer, please, ma'am?

Dr. O'NEILL [continuing]. With potentially devastating effects on the economy. Is that all right?

Chairman DOMENICI. That is better.

Dr. O'NEILL. The Nation's current budget policies, therefore, are not sustainable in the long run. Balancing the budget by 2002 will help alleviate the pressures, particularly if the balanced budget plan includes measures that would slow the growth of entitlement spending. But the size of the future problem is so great that eliminating the deficit by 2002 alone would not ensure that future deficits remain at an acceptable level, requiring that additional deficit reduction measures be taken.

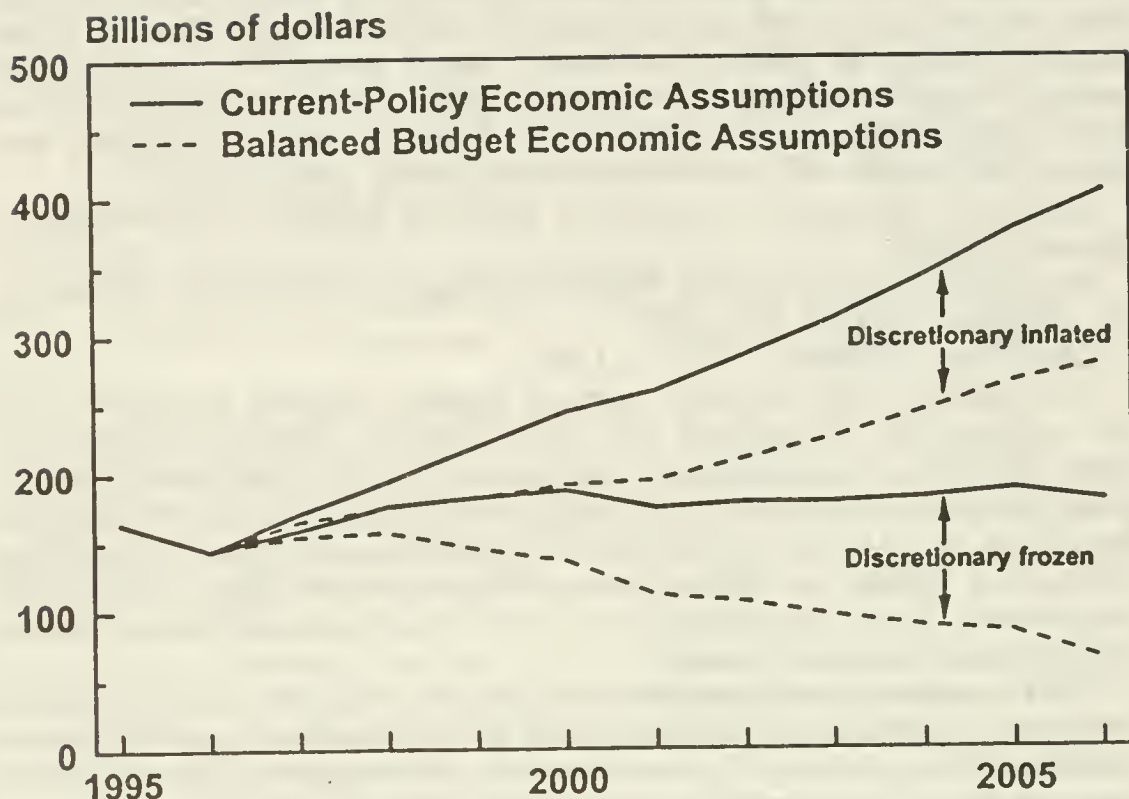
CBO's current projection for 1996 shows a deficit of \$144 billion, which is 1.9 percent of GDP. That is \$63 billion less than CBO had anticipated a year ago in our January 1995 report. Three factors account for the change in our estimates: one, lower interest rates; two, 1996 appropriations that are well below the limits allowed by the Budget Enforcement Act; and, three, reductions in our estimates of spending on certain programs, including medicare and medicaid.

Our budget outlook for the years after 1996 is closer to what we were projecting a year ago and does not differ very much at all from our projections of last December.

The economic outlook on which our current projections are based has also not changed significantly since last December. CBO continues to see a basically sound economy that grows very close to its potential growth rate of 2.1 percent.

This year we are presenting four projections of the budget deficit over the next decade. You should have a handout as a visual aid (it is repeated on the easel) that shows the four projections, because it may be difficult to envision them without it. The four projections are based on very different assumptions, and it is evident from the chart that those differences in assumptions make a big difference, since the level and pattern of the deficit is totally different from one projection to another.

CBO Deficit Projections



Unfortunately, having four projections appears to have generated some confusion in the press. Some columnists have seized upon the lowest projection—that is the low dotted line there—and have drawn the mistaken conclusion that CBO has made it easier to balance the budget by serving up more favorable assumptions. In fact, our projections have changed very little from December, provided that you compare December apples with April apples and do not compare December apples with April avocados or some other species of fruit or vegetable.

In developing the four projections, we have used two sets of economic assumptions and two sets of assumptions about the growth of discretionary spending. The two projections shown by the dark solid lines are based on current-policy economic assumptions, which do not reflect the effects of balancing the budget on interest rates or economic growth. The two projections shown by the dashed lines are based on the premise of a balanced budget, and, therefore, they incorporate a fiscal dividend reflected in lower interest rates and a slightly higher rate of economic growth.

Traditionally, we have presented projections of the baseline budget deficit assuming current policy—that is, no changes are made in policies affecting spending or revenues. But the definition of current policy with respect to program changes has always been somewhat ambiguous where discretionary programs are concerned since those programs are appropriated each year. One can assume that discretionary spending grows with inflation, subject to the caps that set limits on it. Alternatively, one can assume that discretionary spending is frozen at the 1996 nominal level and, therefore, declines in real terms as the price level rises.

Comparing the two solid lines on the chart—both of which use current policy-economic assumptions—it is apparent that the deficit rises considerably faster if discretionary spending is allowed to rise with inflation.

That top line using current economic policy assumptions and allowing an increase with inflation is the one that has typically been shown in the past. So if you have projections in mind from the past, they would be comparable to that top solid line.

By the year 2002, the deficit with discretionary inflation would reach \$285 billion, compared to \$170 billion in the path without inflation. Thus, although a nominal freeze in discretionary spending would not balance the budget in 2002, it would go a long way toward doing so. However, I would caution that maintaining a nominal freeze in discretionary spending is more easily said than done. Even at the low levels of inflation that CBO anticipates, such a freeze would reduce the purchasing power of discretionary appropriations by 25 percent over the next decade. So a freeze is hardly a passive policy.

Turning now to the projections based on balanced budget economic assumptions, indicated by the dashed lines, they clearly show that the fiscal dividend resulting from deficit reduction has dynamic effects that assist in getting the job done. The combined effect of using balanced budget economic assumptions and assuming that discretionary programs are frozen—and that is the lowest of the four projections—results in a deficit of \$106 billion in 2002 and only \$64 billion in 2006. However, this scenario is only valid if steps are taken not only to hold discretionary spending at 1996 levels, but also to reduce growth in entitlement spending or raise revenues by the amount needed to stay on a deficit reduction path that would lead to balance in 2002.

The budget, therefore, will not balance itself over the next decade. Considerable effort must be applied to attain that goal.

The President submitted a budget in March that is intended to eliminate the deficit by 2002. In an effort to attain that goal, the budget included two sets of policies. The first is based on the presumption that the budget will balance under the Administration's economic and technical assumptions. The second, however, includes contingent policies that would have to be carried out if the Administration's assumptions proved too optimistic and additional deficit reduction was required to balance the budget.

Using our own economic projections that assume a balanced budget, CBO estimates that the basic policies proposed in the President's budget would reduce the deficit substantially below CBO's baseline projections but that the deficit would still total \$81 billion in 2002. You can see that in Table 7¹ of the prepared testimony.

However, if CBO's more cautious assumptions should prove accurate, the package of contingent policies outlined in the President's budget would serve as a fail-safe and further reduce deficits, producing a surplus of \$3 billion in 2002.

Now, to turn to the long run, because CBO's regular current-policy projections extend only through 2006, they do not reflect a

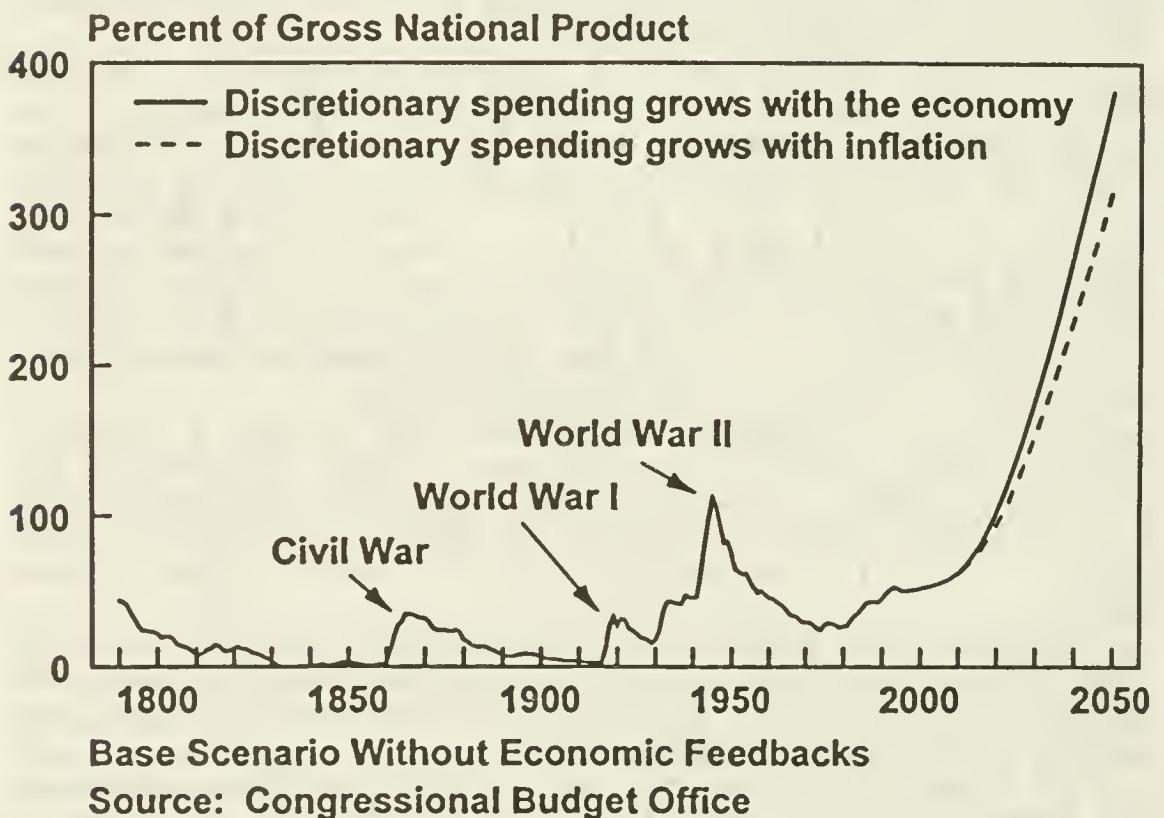
¹ See p. 367.

major event that will first begin to affect deficits about 5 years after the end of the decade: namely, the aging of the baby-boom generation. As the baby boomers retire, both the outlay and revenue sides of the Federal budgetary ledger will be strained. Government outlays will surge as the number of people eligible to receive Social Security, medicare, and medicaid rises sharply. At the same time, revenues will be squeezed because the number of people working and paying taxes will grow more slowly. Moreover, if spending per beneficiary in medicare and medicaid continues to grow faster than the economy, the Federal costs of financing these health care programs for the elderly will grow at an extraordinary pace. Those pressures on the budget will then be magnified by the growth of interest on the borrowing needed to finance the programs.

We have made some calculations of what that would mean using simple assumptions about the other parts of the budget. The simplest of these calculations ignores the feedback effects that growing deficits would place on the economy. Even so, one plausible path of revenues and spending would produce a deficit that rose to 12 percent of GDP by the year 2025, while the debt held by the public reached 135 percent.

The deficit has reached levels that high only during the Second World War, and as shown in the chart on the easel and in the handout, the debt has never been that large. The chart, incidentally, traces the deficit as a share of GNP back to 1800.

Federal Debt Held by the Public



The path of spending and revenues in this scenario clearly cannot be sustained and spirals out of control after 2025. The picture

becomes much worse when we take economic feedbacks into account, since the growth of the debt would raise interest rates and slow the growth of the economy. That would be a 30-year reversed fiscal dividend.

Because of the great uncertainty about both the budgetary and economic assumptions over such a long period, we looked at several different scenarios and tested their sensitivity to changes in assumptions. Under a wide range of plausible scenarios, the results point to one conclusion. Without changes to current policy, the Federal deficit would rise to unprecedented levels in the not too distant future. Those results reinforce the conclusions of other analysts that the aging of the baby boom population will eventually force policymakers to make difficult decisions about paring entitlement benefits or other spending, or increasing taxes.

CBO's analysis also shows that making those changes in the short run will yield considerable benefits in the long run. For example, cutting deficits now reduces the programmatic cuts that would be needed later to bring deficits to the desired levels. In addition, if policies involving retirement age or benefit levels are changed, current workers should have a chance to plan for their retirement with those changes in mind. That is an equity consideration.

Regardless of what policy changes are made, the economic benefits of achieving a long-term sustainable budget policy would be quite large. For example, permanently balancing the budget could raise real incomes in the United States by 10 percent to 15 percent by the year 2025 and by larger percentages in the years thereafter.

I will close with that, and I would be happy to answer any questions.

The prepared statement of Dr. O'Neill follows:]

PREPARED STATEMENT OF JUNE E. O'NEILL, DIRECTOR,
CONGRESSIONAL BUDGET OFFICE

Chairman Domenici, Senator Exon, and Members of the Committee, I am pleased to be with you this morning to review the state of the economy and the budget. Three weeks ago, the Congressional Budget Office (CBO) released *The Economic and Budget Outlook, Fiscal Years 1997-2006: A Preliminary Report*, which presents our current views. My testimony today summarizes that report and presents updated baseline budgetary projections that have been slightly revised to reflect the enactment since that report was issued of the farm bill, the spending and revenue provisions in the debt limit bill, and a new continuing resolution. It also summarizes CBO's analysis of the President's recent budget submission, as well as work that CBO has done on the long-term budgetary effects of the aging of the baby-boom population. Along with more detailed information on baseline projections, those analyses will be published in CBO's annual report to be released next month.

CBO projects that the deficit will decline for the fourth straight year in fiscal year 1996 and that the economy will continue to expand at a moderate rate. But if current policies for revenues and entitlements are not changed, and if discretionary appropriations keep pace with inflation, the deficit will begin to grow steadily in 1997. If discretionary spending is not adjusted for inflation, the deficit will level off in nominal terms at about \$180 billion and shrink in relation to the size of the economy. Both the Congress and the President, however, have proposed changes in policies that would balance the budget by 2002.

The President presented a set of policy changes intended to eliminate the deficit in the budget he submitted in March. Under CBO's more cautious economic and technical assumptions, the basic policies outlined in the President's budget would bring down the deficit to about \$80 billion by 2002 instead of producing the budget surplus that the Administration estimates. However, CBO estimates that additional, contingent policies proposed in the budget, which are to be carried out if deficits are higher than the Administration projects, would produce a small surplus in 2002.

Because CBO's regular current-policy projections extend only through 2006, they do not reflect a major event that will first begin to affect deficits about five years after 2006--namely, the aging of the baby-boom generation. Combined with anticipated continued growth in the per-person cost of Medicare, the increase in the number of beneficiaries of federal programs for the elderly and a slowing in the rate of growth of the labor force will put enormous pressure on the budget. If those pressures are not dealt with by reducing spending or increasing taxes, the mounting deficits could seriously erode future economic growth. Balancing the budget by 2002 will help alleviate the pressures, particularly if the deficit reduction package enacted includes measures that would slow the growth of entitlement spending. But the size of the future problem is so great that eliminating the deficit by 2002 would not alone ensure that future deficits remain at an acceptable level without additional changes in spending and taxes.

THE BUDGET OUTLOOK UNDER CURRENT POLICIES

CBO projects that the deficit will fall to \$144 billion in 1996, or 1.9 percent of gross domestic product (GDP). That figure is \$28 billion lower than CBO predicted last winter in its report *The Economic and Budget Outlook: December 1995 Update*. The reduction in the estimated deficit stems largely from enacted appropriations. Those appropriations are expected to reduce discretionary spending by almost \$20 billion from the statutory limit on discretionary outlays that CBO used as the basis for its December baseline projections.

CBO's current outlook for the deficit after 1996 is not very different from its December one. On average, the deficits projected for 1997 through 2005 in the comparable current baseline are lower than CBO's December projections by about 0.2 percent of GDP.

Estimates of the size of the deficit in 1997 and its course after that depend heavily on assumptions about economic conditions and the level of discretionary spending that annual appropriation legislation will provide. For the annual report this year, CBO has produced four different baseline projections of spending and revenues, which vary according to assumptions made about the course of the economy and the growth of discretionary spending. For all four of the baseline projections, CBO

assumes that current laws governing mandatory spending programs and revenues will not change.

Economic Assumptions

CBO has produced two sets of economic projections. The first set is the traditional one for the annual report, which assumes no change in current budgetary policies. Therefore, those economic projections are consistent with projections of the levels of spending, revenues, and deficits that will occur if budgetary policies do not in fact change.

A second set of projections incorporates the economic effects anticipated if the deficit is eliminated by 2002--a goal that both the Congress and the President have endorsed. CBO assumes that balancing the budget would lower interest rates and slightly increase economic growth. Consequently, federal interest payments would decrease and revenues would increase. As with CBO's economic forecast of last December, this set of projections was developed as an aid to policymakers considering plans to balance the budget by 2002. It does not represent an alternative projection of the course of the economy if no such plan is carried out.

The economic outlook has not changed significantly since December. CBO continues to believe that the U.S. economy is fundamentally sound and estimates that the chances of a major downturn in the next two years are not high. CBO does not attempt to forecast cyclical economic patterns beyond two years. Hence, economic projections for 1997 through 2006 represent CBO's estimates of the average economic performance over the period, based on an assessment of the fundamental factors affecting the economy.

Under the current-policy economic assumptions, CBO projects that the economy, as measured by real GDP, will grow at slightly below its noninflationary potential rate of growth over the next three years. After that, CBO assumes that the economy will on average grow at the potential rate—estimated by CBO to be 2.1 percent a year (see Table 1 on page 23). The unemployment rate is expected to average 6 percent over the 1997-2006 period, 0.4 percentage points above the rate for the first quarter of 1996. The projected level is also slightly above CBO's estimate of the nonaccelerating inflation rate of unemployment (NAIRU) because the average unemployment rate has historically been slightly higher than the NAIRU. Inflation, as measured by the consumer price index, will climb slightly over the next two years but will average a moderate rate of about 3 percent a year during the 1997-2006 period. CBO forecasts little change in long-term and short-term interest rates over the next two years. Similarly, it projects that the average level of interest rates for 1998 through 2006 will be close to current levels.

If instead of assuming that current budgetary policies continue, CBO assumes that the budget will be balanced by 2002, projected interest rates would be 110 basis points (1.1 percentage points) lower by 2002, and real growth would be 0.1 percentage point a year higher (see Table 2). The economic projections that assume a balanced budget are quite similar to CBO's December 1995 projections, which also assumed a balanced budget by 2002.

Assumptions About Discretionary Spending

As with the economic variables, CBO has made two different assumptions about the path of discretionary spending. Such spending is uncertain under current law because it is governed by annual appropriations instead of permanent law. The starting point for both sets of projections is the level of appropriations enacted for 1996 (assuming the amount of spending that would result from extending the current continuing resolution for a full year).

In the first set of projections, discretionary spending is assumed to grow at the rate of inflation up to the statutory caps imposed on it through 1998. CBO projects that 1996 appropriations from the Violent Crime Reduction Trust Fund (VCRTF) adjusted for inflation will be below the limit set on that spending in both 1997 and 1998. Consequently, the caps would not affect VCRTF spending.

However, although inflated general-purpose discretionary spending (all discretionary spending other than VCRTF spending) will be below its cap in 1997, it will exceed the cap in 1998. Therefore, CBO assumes that general-purpose discretionary spending will equal the cap in 1998 and will grow from that level at the rate of inflation in 1999 through 2006.

In the second set of projections, discretionary funding remains frozen at the dollar level provided in the 1996 appropriation bills in all years through 2006. In that case, the caps never become constraining.

Baseline Budget Projections

The combination of two alternative assumptions about the economy and two assumptions about discretionary spending produces four different sets of deficit projections (see Table 3).

Under current-policy economic assumptions, the projected deficit will grow steadily, both in nominal terms and as a percentage of GDP, if discretionary spending is at the cap level adjusted for inflation. If discretionary spending policy is to freeze appropriations at the 1996 dollar amount, deficits will level off at around \$180 billion a year and decrease as a percentage of GDP. Even at the relatively low levels of

inflation that CBO assumes over the next 10 years, such a freeze would cut the purchasing power of discretionary appropriations by about 25 percent by 2006.

Under the balanced budget economic assumptions, the deficit will grow in both nominal terms and as a percentage of GDP if discretionary spending equals the cap in 1998 and keeps up with inflation after that. However, it will climb more slowly than under the current-policy economic assumptions. The deficit is held down by the so-called fiscal dividend—reductions in payments for interest on the debt and increases in revenues that flow from the lower interest rates and slightly faster economic growth under the economic assumptions that assume a balanced budget. If debt-service savings that stem from the lower deficits are included, the fiscal dividend would lower the deficit by \$75 billion in 2002.¹

If discretionary spending is frozen, the deficit will rise in 1997 and 1998 but then begin to decline. Although the freeze would not produce a balanced budget by 2002 (the deficit would be \$106 billion), it would go a long way toward achieving the policy savings that are needed to reach budgetary balance and produce the economic benefits that this baseline assumes. That outcome is not surprising. Freezing discretionary appropriations at the 1996 level produces discretionary

1. The fiscal dividend described in CBO's report *The Economic and Budget Outlook: December 1995 Update* did not include debt-service savings resulting from the fiscal dividend itself. In addition, the interest component of that fiscal dividend was calculated on the stock of debt that would result if a balanced budget was achieved, not on the higher stock of debt implied by a continuation of current budgetary policies.

outlays in 2002 close to the level assumed by the Congress in the budget resolution for 1996. Under its December economic assumptions, CBO estimated that, given the level of discretionary spending assumed in the budget resolution, the approximately \$100 billion in net deficit reduction in 2002 resulting from changes in entitlement and revenue policies proposed in H.R. 2491, the Balanced Budget Act, would eliminate the deficit in 2002.

Of course, the full amount of the savings from the fiscal dividend would result only if the budget was in fact balanced. Therefore, a baseline that reflects the economic improvements from balancing the budget but has large deficits resulting from projections of revenues and spending under current policies is internally inconsistent. Such a baseline, however, is a useful tool because it indicates the amount of direct savings from policy changes that is needed to balance the budget. Section 203 of the third continuing resolution (Public Law 104-56) directed CBO to produce a baseline in December on just such a basis to aid discussions between the Congress and the Administration on balancing the budget. The current projections based on balanced budget economic assumptions should be useful to the Budget Committees in putting together a budget resolution plan to balance the budget. CBO also used them to analyze the President's March 19 budget submission, which does balance the budget by 2002. In addition, CBO can compare the projections with the December baseline.

Changes Since December

CBO's current baseline budget projections using balanced budget economic assumptions and capped discretionary spending (with inflation after 1998) do not differ much from its December baseline projections, which used the same concepts. The currently projected deficit for 1996 is \$28 billion lower than the December projection. However, about two-thirds of that change results from actions on 1996 appropriation bills that the December baseline did not reflect (see Table 4). The reductions in the deficit in the years after 1996 are smaller, by amounts ranging from \$8 billion in 1998 to \$29 billion in 2005. Aside from the effects of the enacted 1996 appropriations on the 1996 and 1997 deficits, relatively little change comes from enacted legislation, since few bills affecting direct spending or revenues have been signed into law since December.

Much of the change in estimated deficits for 1998 through 2005 stems from reductions in projected discretionary spending. The reductions largely reflect an adjustment to the cap that the Office of Management and Budget (OMB) made under the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985 to reflect the Administration's estimate of the measure of inflation used in the cap adjustments. That estimate was lower than a year earlier. Projected spending for a number of mandatory programs (particularly Medicare and Medicaid) is also down, as are interest costs.

Lower projected revenues, however, partially offset those reductions. The drop in revenues results in part from the expiration at the end of calendar year 1995 of the airline ticket tax, which CBO estimates will cost the government \$5 billion in 1996 and \$10 billion by 2005. Under baseline rules, excise taxes dedicated to a trust fund that are scheduled to expire during the projection period are extended in the baseline; however, those taxes are excluded from the baseline if they have already expired before the baseline is released. Thus, those taxes were included in the December baseline but are excluded from the current revenue projections.

The 1997 deficit is affected by a substantial increase in the estimate of the proceeds from ongoing auctions by the Federal Communications Commission of licenses to use parts of the electromagnetic spectrum. The reestimate reflects both a revised estimate of the likely bids in the auctions and a decision by OMB and CBO to record installment payments for the licenses under credit reform procedures on a net present-value basis when a license is issued.

One source of significant change in both mandatory spending and revenue projections—though not shown in Table 4 because it has no net effect on the deficit—is the Telecommunications Act of 1996 (P.L. 104-104), which calls for expanding a fund to provide universal telephone service. Although the receipts and expenditures of the fund do not pass through the government, they clearly would not exist except for action taken by the federal government and thus are ultimately under

the control of the government. OMB and CBO therefore concluded that the transactions of the fund should be recorded as revenues and outlays in the budget. Those transactions include both those provided for by law before the Telecommunications Act was enacted as well as new transactions resulting from the act. Because the projected revenues equal the projected outlays in every year, including those transactions in the budget does not affect the deficit.

Additional Details of the Projections

The major sources of revenues, the major categories of spending, and the deficit under CBO's new baseline projections with current-policy economic assumptions and capped inflated discretionary spending are shown in Table 5. More detailed baseline projections of major mandatory spending programs are shown in Table 6.

BUDGET PROJECTIONS UNDER THE PRESIDENT'S POLICIES

The President submitted a budget in March that is intended to eliminate the deficit by 2002. To help ensure that the goal is achieved, the budget included two sets of policies: one that the Administration estimates will balance the budget if the Administration's economic and technical assumptions are accurate, and contingent

policies that would have to be carried out if the Administration's assumptions prove too optimistic and additional deficit reduction is required to balance the budget.

Using its economic projections that assume a balanced budget, CBO estimates that the basic policies proposed in the President's budget would lower the deficit substantially below CBO's baseline projections but that the deficit would still total \$81 billion in 2002 (see Table 7). The budget would achieve deficit reductions with proposals that hold the growth of discretionary appropriations below the rate of inflation, cut the growth of Medicare and Medicaid below current-law projections, reduce projected spending for welfare programs, and limit other mandatory spending. It also proposes to shrink the deficit through sales of government assets and the auctioning of additional portions of the electromagnetic spectrum. The savings would be partially offset by a net reduction in revenues resulting from a combination of tax cuts and increases.

CBO's estimates of the deficits under the President's basic policies are higher than those of the Administration largely because CBO's baseline projections of the deficit are higher than the Administration's. The Administration's economic assumptions do not differ that much from CBO's economic projections under a balanced budget. The Administration assumes a slightly higher rate of real growth, and the projections differ in a number of other details. But, however slight, those differences do produce noticeably different deficit projections. The largest difference

is in the estimates of revenues: CBO projects current-policy revenues that are \$73 billion lower under its balanced budget economic assumptions than under the Administration's economic forecast. CBO also assumes that Medicaid and some other mandatory programs will grow more rapidly under current policy than does the Administration. In addition, CBO estimates that a number of the President's proposed policy changes will reduce the deficit less than the Administration assumes. For instance, the Administration assumes that the proposed changes in the Medicaid program will cut spending by \$27 billion in 2002. CBO estimates that the proposal will save \$22 billion.

The package of contingent policies outlined in the President's budget would further reduce deficits, producing a surplus of \$3 billion in 2002. Those policies call for the sunset of proposed tax-relief provisions after 2000, additional savings from further restraining Medicare costs, deeper cuts in discretionary spending, and new fees on television broadcasters to offset any shortfall in anticipated receipts from the proposed auction of the right to use the electromagnetic spectrum.

IMPACTS OF AN AGING POPULATION ON THE BUDGET

The aging of Americans born between 1946 and 1964 will dramatically affect the federal budget in the coming century. Because the first members of that baby-boom generation will turn 65 in 2011, those effects are not reflected in CBO's projections of spending and revenues through 2006. In the decades after 2010, however, the demographic shift will push up the deficit rapidly if no changes are made in entitlement benefits for the elderly or in taxes on the working population. Because escalating deficits would reduce investment, increase interest rates, and eventually choke off economic growth, such a path is not sustainable. Although the problem must ultimately be dealt with, it will be less painful to deal with it sooner rather than later.

Demographic Changes

The trustees of the Social Security Old-Age and Survivors and Disability Insurance (OASDI) Trust Funds estimate that the number of citizens 65 or older in 2030 will be more than double the number in 1990, while the number of working-age Americans (20 to 64 years old) will increase only about 25 percent (see Table 8). As a result, the number of retirees to be supported per worker will jump sharply.

The increase in the number of the elderly after 2010 will drive up the costs of Social Security. It will also put pressure on Medicare, which provides basic health care coverage for most people 65 and over, and Medicaid, which provides long-term care and some other assistance for the poor elderly. At the same time, revenues will grow more slowly because the growth in the number of workers will slow.

Budgetary and Economic Assumptions

The concept of a current-policy baseline is somewhat ambiguous even for the 10-year projections of spending and outlays described earlier. Over a much longer period, the approach used in those projections would produce misleading results. For instance, freezing discretionary spending at the 1996 dollar level over the next 10 years is one possible interpretation of current policy in CBO's 10-year projections, even though that level of spending would purchase only about three-fourths as much in 2006 as in 1996. But if such a freeze were continued for another 40 years, even at the relatively low inflation rate of 3 percent, discretionary appropriations would cover less than one-fourth of the cost of the armed forces, law enforcement officials, highway construction, and other goods and services that are being provided in 1996 although the population would be significantly larger.

Therefore, CBO did not attempt to extend its regular budgetary projections beyond 2006. For Social Security, Medicare, and federal retirement programs, CBO simply adopted the long-term projections made by trustees of those programs (or the Office of Personnel Management and the Department of Defense in the case of federal retirement) and adjusted for any differences between CBO's economic assumptions and those of the trustees. Various broad national income and product account (NIPA) categories of other spending were assumed to grow according to simple rules applied to each category. For instance, transfer payments (other than those included in the trustees' projections) were assumed to grow with demographic demands, labor productivity, and inflation. In the case of discretionary spending, CBO used two alternative assumptions. In one scenario, expenditures grow at the same rate as the economy. In the other, they increase at the rate of inflation. CBO assumes that revenues will remain a stable share of economic income, except for an adjustment for the growth in interest income on the federal debt and Medicare Supplementary Medical Insurance premiums, which are treated as revenues in NIPA accounting.

Similarly, in order to assess the effect of long-run budget policies, CBO had to make assumptions about fundamental forces in the economy over the coming decades. Reflecting the anticipated slowing in the growth of the labor force, CBO's base cases assume that annual growth in the total hours of work will drop from 1.2 percent in 1995 to almost nothing in 2025. Assuming further that total factor

productivity continues to grow at the average rate since 1947, annual growth of real GDP is projected to slip from 2.1 percent in 2005 to 1.2 percent in 2025 before any effects that increasing deficits will have on growth are factored in.

Long-Term Budget Projections

Because of the great uncertainty about both the budgetary and economic assumptions, CBO looked at several different scenarios and tested the sensitivity of its results to changes in the assumptions. Under an array of plausible scenarios, the deficit would grow as a percentage of GDP after about 2010. The level of the deficit in relation to the size of the economy would depend on the specific assumptions about growth in spending and revenues and on assumptions about population growth, increases in productivity, and the effects of mounting deficits on the economy.

Even without assuming any economic feedback effects from increasing deficits, one seemingly plausible path of revenues and spending (with discretionary spending growing at the rate of the economy after 2006) would produce a deficit that equals 12 percent of GDP by 2025 and debt held by the public equal to 135 percent of GDP (see Table 9). The deficit has reached levels that high only during World War II, and the debt has never been that large. The path of spending and revenues in this scenario clearly cannot be sustained because the debt-to-GDP ratio spirals out

of control after 2025. Interest payments would consume an ever larger share of federal spending.

For a path of spending and revenues to be sustainable, the resulting debt must grow no faster than the economy. One measure of the size of the problem presented by burgeoning deficits is the increase in revenues (or reduction in spending) needed to keep the debt as a percentage of GDP from exceeding its current level for the foreseeable future. Assuming that discretionary spending grows at the rate of the economy, CBO estimates that increasing revenues by an amount equal to 5 percent of GDP would achieve that goal. Since revenues in the scenario equal 20 percent of GDP, that amount would represent about a 25 percent hike in revenues. If discretionary spending is assumed to grow only at the rate of inflation after 2006, a revenue increase equal to about 3 percent of GDP (or 15 percent of revenues) would keep the debt as a percentage of GDP at or below its current level.

Other assumptions about the growth of spending produce lower projected deficits and debt. However, taking economic feedbacks into account will produce projected deficits that are significantly higher, reaching about 20 percent of GDP by 2025, assuming that discretionary spending grows with the economy. These projections are much worse because they assume that burgeoning deficits will crowd out capital, which pushes up interest rates and slows the growth of the economy. As a result, the federal tax base is weaker and federal interest costs are higher. Although

the precise path of deficits and debt as a percentage of GDP depends on the particular assumptions about demographics, productivity, and the growth of discretionary spending, the projected deficits and debt in all of the scenarios that assume the economic feedbacks and no change in policy eventually soar to levels that are clearly not sustainable.

Those results reinforce the conclusions of other analysts that the aging of the baby-boom population will eventually force policymakers to make difficult decisions about paring entitlement benefits or other spending or increasing taxes. CBO's analysis also shows that making those changes now will yield considerable benefits. For example, cutting deficits now trims future debt and interest payments on the debt, thereby reducing the programmatic cuts that would be needed later to cut deficits to the desired levels. In addition, if policies involving retirement age or benefit levels are changed, current workers should have a chance to plan for their retirement with those changes in mind. Regardless of what policy changes are made, the economic benefits of achieving a long-term, sustainable budget policy would be quite large. For example, permanently balancing the budget could raise real incomes in the United States by 10 percent to 15 percent by 2025 and by larger percentages in years thereafter.

Effect of the President's Budgetary Proposals

The President's budget proposes policies that CBO estimates would balance the budget by 2002. Because of the lack of details about the President's policies after 2002 and the imprecision of long-term budget projections, it is impossible to assess fully the long-term effects of adopting the President's policies. Even if the rates of growth of spending and revenues after 2002 did not change compared with CBO's assumptions based on no change in policy, the long-term picture would be brighter because of the reduction in accumulated debt in 2002. Achieving a fiscal policy that is sustainable in the very long run, however, would require further increases in revenues or reductions in the growth of spending after 2002. The Administration has estimated that spending will grow more slowly after 2002 under the President's policies than CBO has assumed in its current-policy scenarios. Based on those assumptions about the effects of the President's policies, the Administration projects a deficit of only 1 percent of GDP in 2050, less than the level in 1995. CBO is examining the Administration's projections, as well as other long-term scenarios that start from a balanced budget in 2002. The results from the analysis are not yet available but will be included in CBO's annual report.

CONCLUSION

Although the projected deficit for 1996 is \$28 billion lower than we estimated last December, CBO's fundamental outlook for the economy and the budget has changed little since December. If current policies governing federal entitlement spending and revenues are not changed, and if discretionary appropriations are allowed to keep pace with inflation, the deficit will begin climbing steadily in 1997 after declining four years in a row. The budget problem will grow worse after 2010 when the baby-boom population begins to retire and will put great pressure on the costs of Social Security, Medicare, and other programs for the elderly. The President has proposed changes in policies that would balance the budget in 2002, but the extent to which those policies would ease the budgetary problems from the aging of the baby-boomers is uncertain. CBO plans to analyze further the effects of proposals to balance the budget by 2002 on the long-term budgetary problems.

Table 1.
Economic Projections for Calendar Years 1996 Through 2006 Assuming Current Policy

	Preliminary ^a 1995	Forecast		Projected								
		1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Nominal GDP (Billions of dollars)	7,248	7,584	7,943	8,324	8,730	9,156	9,603	10,071	10,563	11,078	11,619	12,185
Nominal GDP (Percentage change)	4.6	4.6	4.7	4.8	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Real GDP ^b (Percentage change)	2.1	2.0	1.9	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
Chained Price Index (Percentage change)	2.5	2.6	2.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
CPI-U ^c (Percentage change)	2.8	2.8	3.1	3.0	2.9	2.9	2.9	3.0	3.0	3.0	3.0	3.0
Unemployment Rate (Percent)	5.6	5.6	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Three-Month Treasury Bill Rate (Percent)	5.5	4.9	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Ten-Year Treasury Note Rate (Percent)	6.6	6.1	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4
Tax Bases												
(Billions of dollars)												
Corporate profits	579	599	612	618	620	629	648	672	703	741	780	822
Other taxable income	1,529	1,595	1,662	1,757	1,859	1,958	2,058	2,157	2,259	2,367	2,482	2,604
Wage and salary disbursements	<u>3,420</u>	<u>3,592</u>	<u>3,760</u>	<u>3,935</u>	<u>4,124</u>	<u>4,322</u>	<u>4,528</u>	<u>4,743</u>	<u>4,969</u>	<u>5,205</u>	<u>5,452</u>	<u>5,711</u>
Total	5,528	5,786	6,035	6,309	6,603	6,909	7,233	7,572	7,931	8,313	8,714	9,137
Tax Bases												
(Percentage of GDP)												
Corporate profits	8.0	7.9	7.7	7.4	7.1	6.9	6.7	6.7	6.7	6.7	6.7	6.7
Other taxable income	21.1	21.0	20.9	21.1	21.3	21.4	21.4	21.4	21.4	21.4	21.4	21.4
Wage and salary disbursements	<u>47.2</u>	<u>47.4</u>	<u>47.3</u>	<u>47.3</u>	<u>47.2</u>	<u>47.2</u>	<u>47.2</u>	<u>47.1</u>	<u>47.0</u>	<u>47.0</u>	<u>46.9</u>	<u>46.9</u>
Total	76.3	76.3	76.0	75.8	75.6	75.5	75.3	75.2	75.1	75.0	75.0	75.0

SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

NOTE: GDP = gross domestic product.

a. Consistent with the first official estimate for 1995 published on March 4, 1996.

b. Based on chained (1992) dollars.

c. CPI-U is the consumer price index for all urban consumers.

Table 2.
Economic Projections for Calendar Years 1996 Through 2006 Assuming Balanced Budget Policy

	Preliminary ^a	Forecast		Projected								
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Nominal GDP (Billions of dollars)	7,248	7,584	7,946	8,333	8,745	9,177	9,631	10,108	10,608	11,133	11,684	12,261
Nominal GDP (Percentage change)	4.8	4.8	4.8	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Real GDP ^b (Percentage change)	2.1	2.0	2.0	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Chained Price Index (Percentage change)	2.5	2.6	2.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
CPI-U ^c (Percentage change)	2.8	2.8	3.1	3.0	2.9	2.9	2.9	3.0	3.0	3.0	3.0	3.0
Unemployment Rate (Percent)	5.6	5.6	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Three-Month Treasury Bill Rate (Percent)	5.5	4.9	4.8	4.3	3.9	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Ten-Year Treasury Note Rate (Percent)	6.6	5.7	5.5	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Tax Bases												
(Billions of dollars)												
Corporate profits	579	602	637	668	691	716	741	778	817	857	899	944
Other taxable income	1,529	1,590	1,635	1,700	1,779	1,860	1,946	2,032	2,127	2,227	2,334	2,448
Wage and salary disbursements	<u>3,420</u>	<u>3,582</u>	<u>3,762</u>	<u>3,939</u>	<u>4,131</u>	<u>4,332</u>	<u>4,541</u>	<u>4,761</u>	<u>4,990</u>	<u>5,230</u>	<u>5,482</u>	<u>5,746</u>
Total	5,528	5,784	6,034	6,307	6,601	6,907	7,228	7,570	7,933	8,315	8,716	9,138
Tax Bases												
(Percentage of GDP)												
Corporate profits	8.0	7.9	8.0	8.0	7.9	7.8	7.7	7.7	7.7	7.7	7.7	7.7
Other taxable income	21.1	21.0	20.8	20.4	20.3	20.3	20.2	20.1	20.0	20.0	20.0	20.0
Wage and salary disbursements	<u>47.2</u>	<u>47.4</u>	<u>47.3</u>	<u>47.3</u>	<u>47.2</u>	<u>47.2</u>	<u>47.2</u>	<u>47.1</u>	<u>47.0</u>	<u>47.0</u>	<u>46.9</u>	<u>46.9</u>
Total	76.3	76.3	75.9	75.7	75.5	75.3	75.0	74.9	74.8	74.7	74.6	74.5

SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

NOTE: GDP = gross domestic product.

a. Consistent with the first official estimate for 1995 published on March 4, 1996.

b. Based on chained (1992) dollars.

c. CPI-U is the consumer price index for all urban consumers.

Table 3.
CBO Deficit Projections (By fiscal year)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
In Billions of Dollars												
Baseline Total Deficit with Current-Policy Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	164	144	171	194	219	244	259	285	311	342	376	403
Freeze discretionary spending at 1996 dollar level	164	144	159	176	182	187	174	178	178	181	187	179
Baseline Total Deficit with Balanced Budget Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	164	144	165	175	182	191	194	210	225	244	265	278
Freeze discretionary spending at 1996 dollar level	164	144	154	157	145	136	111	106	96	88	84	64
As a Percentage of Gross Domestic Product												
Baseline Total Deficit with Current-Policy Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	2.3	1.9	2.2	2.4	2.5	2.7	2.7	2.9	3.0	3.1	3.3	3.3
Freeze discretionary spending at 1996 dollar level	2.3	1.9	2.0	2.1	2.1	2.1	1.8	1.8	1.7	1.6	1.6	1.5
Baseline Total Deficit with Balanced Budget Economic Assumptions												
Cap discretionary spending (with inflation after 1998)	2.3	1.9	2.1	2.1	2.1	2.1	2.0	2.1	2.1	2.2	2.3	2.3
Freeze discretionary spending at 1996 dollar level	2.3	1.9	2.0	1.9	1.7	1.5	1.2	1.1	0.9	0.8	0.7	0.5

SOURCE: Congressional Budget Office.

Table 4. Changes in CBO Deficit Projections Since December (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
December Baseline Deficit	172	182	183	195	204	211	228	244	266	294
Legislative Changes										
Revenues	a	a	a	a	a	a	a	a	a	a
Discretionary outlays	-19	-8	0	0	0	0	0	0	0	0
Mandatory outlays										
Farm bill	3	1	-1	-1	-1	-2	-2	-1	-1	-1
Other	a	a	a	-1	-1	a	a	a	a	a
Subtotal	3	2	-1	-2	-2	-2	-2	-1	-1	-1
Deficit	-15	-6	-1	-2	-2	-2	-2	-1	-1	-1
Economic Changes										
Revenues	-2	1	1	2	5	6	8	11	13	15
Outlays										
Net Interest	-2	-6	-6	-7	-8	-10	-14	-18	-22	-29
Other mandatory outlays	-1	-2	-2	-2	-2	-2	-2	-2	-2	-2
Subtotal	-4	-8	-8	-10	-11	-12	-17	-20	-25	-31
Deficit	-6	-7	-8	-7	-6	-6	-9	-9	-12	-17
Technical Changes										
Revenues										
Expiring excise taxes	5	7	8	8	8	9	9	10	10	11
Other revenues	-1	-2	-1	-1	-1	-1	-1	-1	-1	-1
Subtotal	4	5	7	7	8	8	8	9	9	10
Discretionary outlays										
Mandatory outlays	0	0	-10	-9	-10	-10	-10	-10	-11	-11
Medicare and Medicaid										
Social Security	-2	-3	-2	-1	-5	-7	-9	-11	-14	-19
Supplemental Security Income	-1	-1	-1	-1	-2	-2	-3	-3	-4	-5
Electromagnetic spectrum auctions	a	a	-2	a	a	0	0	0	0	0
Net Interest	-3	-10	-2	a	1	1	3	4	6	9
Other mandatory outlays	-1	8	a	1	6	5	5	5	7	7
Subtotal	a	6	10	4	6	5	5	5	7	7
Deficit	-7	-3	-1	-3	-4	-9	-7	-9	-9	-12
Debt Service										
Total Changes	a	-1	-1	-1	-1	-1	-1	-1	-2	-2
April Baseline Deficit with Balanced Budget	-28	-16	-8	-13	-12	-16	-18	-19	-22	-29
Economic Assumptions										
April Baseline Deficit with Balanced Budget	144	165	175	182	191	194	210	225	244	265
Changes from Adopting Current Policy										
Economic Assumptions	a	5	19	37	53	64	75	86	98	111
April Baseline Deficit with Current Policy										
Economic Assumptions	144	171	194	219	244	259	285	311	342	376

SOURCE: Congressional Budget Office.

NOTES: Reductions in revenues are shown with a positive sign because they increase the deficit.

Numbers may not add to totals because of rounding.

a. Less than \$500 million.

Table 5.
CBO April Baseline Projections Under Current-Policy Economic Assumptions with Discretionary Inflation (By fiscal year)

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
in Billions of Dollars												
Revenues												
Individual income	580	636	661	694	730	769	811	853	898	946	997	1,051
Corporate income	157	169	171	172	171	171	174	179	185	194	204	214
Social insurance	484	504	531	553	580	609	636	666	696	727	762	800
Other	123	118	120	124	128	132	137	142	151	158	162	168
Total	1,355	1,428	1,483	1,544	1,608	1,681	1,758	1,840	1,931	2,023	2,124	2,232
On-budget	1,004	1,063	1,098	1,142	1,186	1,236	1,294	1,354	1,423	1,493	1,568	1,649
Off-budget	351	365	385	402	423	444	464	486	508	530	558	584
Outlays												
Discretionary*	546	533	546	546	563	579	596	614	632	651	671	691
Mandatory	822	875	946	1,011	1,070	1,141	1,205	1,285	1,369	1,457	1,557	1,655
Net interest	232	240	246	257	271	283	296	311	328	346	365	385
Offsetting receipts	-80	-75	-84	-77	-76	-78	-81	-85	-88	-90	-93	-98
Total	1,519	1,572	1,654	1,737	1,828	1,925	2,016	2,125	2,242	2,365	2,500	2,638
On-budget	1,230	1,272	1,340	1,410	1,491	1,573	1,648	1,743	1,844	1,952	2,071	2,190
Off-budget	289	300	314	327	337	352	368	382	398	413	429	448
Deficit	164	144	171	194	219	244	259	285	311	342	376	403
On-budget deficit	226	209	242	268	305	337	354	389	421	459	503	541
Off-budget surplus	62	65	71	74	86	92	96	104	110	117	127	138
Debt Held by the Public	3,603	3,770	3,967	4,181	4,422	4,687	4,966	5,268	5,593	5,947	6,333	6,746

(Continued)

Table 5.
Continued

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
As a Percentage of Gross Domestic Product												
Revenues												
Individual income	8.2	8.5	8.4	8.4	8.5	8.5	8.5	8.6	8.6	8.6	8.7	8.7
Corporate income	2.2	2.3	2.2	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	1.8
Social insurance	6.7	6.7	6.8	6.7	6.7	6.7	6.7	6.7	6.7	6.6	6.6	6.6
Other	1.7	1.6	1.5	1.5	1.5	1.5	1.4	1.4	1.4	1.4	1.4	1.4
Total	18.9	19.1	18.9	18.8	18.7	18.6	18.5	18.5	18.5	18.5	18.5	18.5
On-budget	14.0	14.2	14.0	13.9	13.8	13.7	13.6	13.6	13.6	13.6	13.7	13.7
Off-budget	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.8	4.8
Outlays												
Discretionary*	7.6	7.1	7.0	6.6	6.5	6.4	6.3	6.2	6.1	5.9	5.8	5.7
Mandatory	11.4	11.7	12.0	12.3	12.4	12.6	12.7	12.9	13.1	13.3	13.6	13.7
Net interest	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.2	3.2	3.2
Offsetting receipts	-1.1	-1.0	-1.1	-0.9	-0.9	-0.9	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8
Total	21.2	21.0	21.1	21.1	21.2	21.3	21.3	21.4	21.5	21.6	21.8	21.9
On-budget	17.1	17.0	17.1	17.1	17.3	17.4	17.4	17.5	17.7	17.8	18.0	18.2
Off-budget	4.0	4.0	4.0	4.0	3.9	3.9	3.9	3.8	3.8	3.8	3.7	3.7
Deficit	2.3	1.9	2.1	2.4	2.5	2.7	2.7	2.9	3.0	3.1	3.3	3.3
On-budget deficit	3.2	2.8	3.1	3.3	3.5	3.7	3.7	3.9	4.0	4.2	4.4	4.5
Off-budget surplus	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1
Debt Held by the Public	60.2	60.3	60.5	60.6	61.3	61.6	62.3	62.9	63.6	64.3	65.2	66.0
Memorandum:												
Gross Domestic Product (Billions of Dollars)	7,181	7,491	7,853	8,225	8,627	9,047	9,468	9,952	10,438	10,947	11,481	12,041

SOURCE: Congressional Budget Office.

a. Discretionary spending is adjusted for inflation up to the statutory caps that are in effect through 1998. General-purpose discretionary spending is assumed to equal the cap in 1998 and to grow from that level at the rate of inflation in later years.

Table 8.
CBO April Baseline Projections for Mandatory Spending, Including Deposit Insurance (By fiscal year, in billions of dollars)

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Means-Tested Programs												
Medicaid	89	96	105	115	126	138	152	168	183	201	221	243
Food Stamps ^a	26	26	28	30	31	32	34	35	37	38	40	41
Supplemental Security Income	25	24	28	30	33	36	35	40	43	46	54	53
Family Support	18	18	19	19	20	21	21	22	23	23	24	25
Veterans' Pensions	3	3	3	3	3	4	3	4	4	4	4	4
Child Nutrition	7	8	8	9	10	10	11	11	12	13	13	14
Earned Income Tax Credit	15	18	20	21	22	23	23	24	25	26	27	28
Student Loans ^b	4	2	2	2	3	3	3	3	3	3	4	4
Other	3	4	4	4	5	5	6	6	7	7	8	8
Total	191	199	217	234	252	274	287	312	336	362	394	420
Non-Means-Tested Programs												
Social Security	333	348	365	383	402	422	444	467	490	515	540	567
Medicare	177	196	216	236	257	278	303	328	357	389	424	463
Subtotal	810	644	681	620	660	702	747	795	847	904	964	1,030
Other Retirement and Disability												
Federal civilian ^c	43	44	46	49	51	54	57	60	63	67	71	75
Military	28	29	30	31	33	34	35	36	36	38	39	40
Other	5	5	5	5	5	5	5	5	5	5	5	5
Subtotal	75	77	81	84	86	92	96	100	105	110	115	121
Unemployment Compensation	21	24	26	27	28	29	30	31	32	34	35	36
Deposit Insurance	-18	-10	-6	-2	-2	-2	-2	-1	-1	-1	-1	-1
Other Programs												
Veterans' benefits ^d	18	17	19	19	20	21	19	20	21	21	22	21
Farm prices supports	6	7	7	7	7	7	6	6	6	6	6	6
Social services	6	8	6	6	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-2	-7	-7	-6	-6	-6	-6	-6	-6	-6	-7	-7
Other	15	19	20	21	18	20	22	21	23	23	23	23
Subtotal	42	41	45	48	45	47	47	47	49	49	50	49
Total	831	876	928	977	916	968	918	972	1,033	1,066	1,163	1,235
Total												
All Mandatory Spending	822	875	848	1,011	1,070	1,141	1,205	1,285	1,369	1,457	1,557	1,655

SOURCE: Congressional Budget Office.

NOTE: Spending for benefit programs shown above generally excludes administrative costs, which are discretionary. Spending for Medicare also excludes premiums, which are considered offsetting receipts.

- a. Includes nutrition assistance to Puerto Rico.
- b. Formerly known as guaranteed student loans.
- c. Includes Civil Service, Foreign Service, Coast Guard, other retirement programs, and annuities' health benefits.
- d. Includes veterans compensation, readjustment benefits, life insurance, and housing programs.

Table 7.
CBO Reestimate of the President's Budget (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	1998-2002
CBO Baseline Deficit^a	144	165	175	182	191	194	210	n.a.
President's Basic Budgetary Proposals								
Revenues ^b								
Tax relief								
Child tax credit	0	10	8	9	13	13	13	64
Higher education deduction	0	7	6	7	7	7	8	41
Individual retirement account	0	1	1	1	2	4	5	14
Other tax relief	0	1	1	2	2	2	2	9
Subtotal, tax relief	0	18	16	18	23	26	28	128
Extend expired excise taxes	0	4	6	6	6	7	7	38
Other revenue provisions	0	6	6	10	10	10	12	54
Subtotal, revenues	1	8	2	3	7	9	9	38
Outlays								
Medicare	c	5	8	14	20	26	31	103
Medicaid	0	2	2	6	10	16	22	54
Welfare reform	0	4	6	6	7	7	8	36
FCC spectrum auction	0	c	2	3	4	5	16	31
Proceeds from asset sales	c	1	c	c	c	c	2	4
Discretionary appropriations	2	4	6	26	42	46	38	161
Other policy changes	-1	4	1	-1	-2	-5	-6	-18
Debt service	c	5	1	3	6	11	18	35
Subtotal, outlays	1	17	23	59	91	116	138	444
Total Changes	2	-9	-21	-67	-84	-107	-129	-405
Deficit Under the President's Basic Budgetary Proposals as Estimated by CBO	146	156	153	125	108	87	81	n.a.
President's Contingent Budgetary Proposals								
Sunset tax relief	0	0	c	c	c	-7	-25	-32
Medicare	0	-1	-1	-2	-2	-3	-3	-13
FCC spectrum auction fallback	0	0	0	0	0	0	0	0
Discretionary appropriations	0	0	0	0	0	-22	-46	-67
Debt service	0	c	c	c	c	-1	-1	-6
Total Changes	0	-1	-2	-2	-2	-33	-84	-124
Deficit Under the President's Budgetary Proposals as Estimated by CBO	146	155	152	123	105	54	3	n.a.

SOURCE: Congressional Budget Office.

NOTES: Numbers may not add to totals because of rounding. FCC = Federal Communications Commission; n.a. = not applicable.

- a. This baseline is based on economic projections that assume the budget will be balanced by 2002. It assumes that discretionary spending is equal to 1996 appropriations adjusted for inflation up to the caps that are in effect through 1998. General-purpose discretionary spending is equal to the cap in 1998 and grows from that level at the rate of inflation after that.
- b. Revenue losses are shown with a positive sign because they increase the deficit.
- c. Less than \$500 million.

Table 8.
Population of the United States, by Age, Selected Years, 1950-2070

	Projections					
	1950	1970	1990	2010	2030	2050
	In Millions					
Less than 20 Years Old	54	81	75	82	83	84
20 to 64 Years Old	93	113	153	186	192	202
65 Years and Older	<u>13</u>	<u>21</u>	<u>32</u>	<u>40</u>	<u>68</u>	<u>75</u>
Total	159	215	260	307	343	360
	As a Percentage of Total Population					
Less than 20 Years Old	34	38	29	27	24	23
20 to 64 Years Old	58	53	59	60	56	56
65 Years and Older	<u>8</u>	<u>10</u>	<u>12</u>	<u>13</u>	<u>20</u>	<u>21</u>
Total	100	100	100	100	100	100
Memorandum:						
Ratio of People Age 20 to 64 to People Age 65 Years and Older	7.3	5.4	4.8	4.7	2.8	2.7

SOURCE: Congressional Budget Office based on data from the Social Security Administration.

NOTE: Numbers may not add to totals because of rounding.

Table 9.
Projections of Federal Receipts and Expenditures Measured by the National Income and Product Accounts,
Base Scenario Without Economic Feedbacks, Selected Calendar Years (As a percentage of gross domestic product)

	Preliminary 1995 ^a	2000	2005	2010	2015	2020	2025	2050
Assume Discretionary Spending Grows with the Economy After 2006^b								
Receipts	20	20	20	20	20	20	20	20
Expenditures								
Federal consumption expenditures	8	8	8	8	8	8	8	8
Transfers, grants, and subsidies								
Social Security	5	5	5	5	5	6	6	7
Medicare	3	3	4	4	5	6	7	8
Medicaid	1	2	2	2	3	3	3	4
Other	5	5	4	4	4	4	4	4
Net Interest	<u>-3</u>	<u>-3</u>	<u>-3</u>	<u>-3</u>	<u>-4</u>	<u>-5</u>	<u>-7</u>	<u>-17</u>
Total	23	22	23	24	27	28	32	46
Deficit	2	3	3	5	7	8	12	25
Debt Held by the Public ^c	51	51	56	52	77	102	136	378
Assume Discretionary Spending Grows with Inflation After 2006								
Receipts	20	20	20	20	20	20	20	20
Expenditures								
Federal consumption expenditures	6	6	6	6	4	4	4	3
Transfers, grants, and subsidies								
Social Security	5	5	5	5	5	6	6	7
Medicare	3	3	4	4	5	6	7	8
Medicaid	1	2	2	2	3	3	3	4
Other	5	5	4	4	4	4	4	4
Net Interest	<u>-3</u>	<u>-3</u>	<u>-3</u>	<u>-3</u>	<u>-4</u>	<u>-5</u>	<u>-6</u>	<u>-16</u>
Total	23	22	23	24	28	28	30	41
Deficit	2	3	3	4	6	8	10	20
Debt Held by the Public ^c	50	52	56	51	73	93	120	316
Memorandum:								
Gross Domestic Product (Trillions of dollars)	7.2	9.2	11.6	14.6	18.1	22.1	26.8	71.7

SOURCE: Congressional Budget Office.

a. Consistent with the first official estimate for 1995 published March 4, 1996.

b. Discretionary spending is assumed to grow with net national product.

c. Fiscal year.

Senator EXON. Mr. Chairman, may we pause for just a moment and recognize the newest member of the Budget Committee on this side. I am very pleased that after he was elected, Senator Wyden came to me and expressed an interest in serving on this committee. Thanks primarily to your help and understanding to shift the ratios, he is with us today for the first time. And I just want to thank Senator Wyden, welcome him. We are glad you are part of our group.

Senator WYDEN. Senator, thank you very much, and I also want to extend my thanks to Senator Domenici. I have had a chance as a member of the House to work with both of you in the past, and I just want to tell you I very much appreciate the consideration, and I look forward to being a member of the committee.

Senator EXON. Thank you, Mr. Chairman.

Chairman DOMENICI. Senator, I just wanted to say the reason it took us about 3- or 4-extra days was because I was somewhat dazed to think you wanted to be on this committee. [Laughter.]

Senator EXON. He wanted to hold a sanity hearing.

Senator WYDEN. The news seems so good today.

Chairman DOMENICI. We are glad you are on, and we hope it lives up to the expectation which you must have had when you decided to join us. Right, Senator?

If there is a Senator who really needs accommodating because of time and feels like they would like to inquire, I would depart from the normal rule. Usually, I proceed with questions, Senator Exon proceeds, and then we follow his instructions, and on your side we would go on time of arrival, and on our side the same.

Now, on our side, we don't want to just welcome our new Democrat, because we also have a new Republican. He is sitting right here—Senator Grams—and he wanted to be on this committee not only when we put him on but when he came to the Senate. I can vividly recall going over the list of Senators with Senator Dole, and his name kept coming up as one who wanted on this committee. And we finally have been able to accommodate him, and we are very pleased that he has joined us. Senator, we hope this lives up to your expectations. Do you have any comment?

Senator GRAMS. No; I am just pleased to be here and hope I can be a contributing member, and I am just glad for this opportunity. Thank you very much.

Chairman DOMENICI. Thank you very much.

Senator LAUTENBERG. Mr. Chairman, since we got the wheels on the chairs, I notice that the attendance here in the committee has gone up.

Chairman DOMENICI. For those of you who are unaware, we have things better up here because one of the members kept reminding me, unless he is unwilling to admit to it, that we needed wheels on these chairs, that it was too hard to move them around. We finally succeeded. Because there have been such frugal conditions around here, it took us 2½ years to get wheels. But we have little tiny wheels on here. Is it better, Senator?

Senator LAUTENBERG. Yes. But I like big wheels. [Laughter.]

Chairman DOMENICI. That is why you like me so much?

Senator LAUTENBERG. I like you a lot. I just wonder about our new colleagues on the committee. What brought them here, I don't know.

Chairman DOMENICI. I think what I would like to do, just for a few moments, I would like to try to get my version of what I think the President has done in his budget. And I don't want anybody to think, first of all, that the President has not come a long way. Certainly looking back over the past couple of years from the first budget he submitted for 1996 until this one, clearly there are some substantial changes in the President's attitude and desire to move in the direction of a balanced budget. And I don't think that can be denied. I would also suggest, however, that part of that is to the credit of the Republican majority, which moved rather swiftly and with great determination, and obviously the White House has come along with that approach.

I think, however, the budget that is before us for the year 2001 and 2002 is really pretty filled with gimmicks which the President would choose to call "triggering". So let me see if I have the triggering correct, Dr. O'Neill.

As I understand it, the President says if he is right and you are wrong on economics, he has a balanced budget under his economics. But if your economics are right and his economics are wrong, then I understand in 2002 the President's budget has an \$81 billion deficit. Is that correct?

Dr. O'NEILL. Yes, that is true. Unless the contingency——

Chairman DOMENICI. Well, I am going to get to that.

Dr. O'NEILL. Yes.

Chairman DOMENICI. So then the President says, on the other hand, just to make sure that I really do have a balanced budget, in the year 2002, in the event that the economics which we normally use up here, yours, are the case, then to get to a balanced budget we are going to do the following—and see if I have read them right. We are going to detrigger \$25 billion of the tax cuts that were in place. Is that right?

Dr. O'NEILL. That is true.

Chairman DOMENICI. Raise taxes. So at that point we are going to raise taxes \$25 billion; is that correct?

Dr. O'NEILL. That is correct, yes.

Chairman DOMENICI. Right? Now, so nobody will think I am just picking one issue, I have looked at the taxes in that year, and essentially taxes will literally go up that year by \$16 billion because the amount that will be increased is in excess of the reductions, and so there will be an actual \$16 billion increase. But let me move on.

The big ticket item is a very interesting one because the President says we will get to balance by cutting \$46 billion from the discretionary accounts in 1 year. Do I read it right?

Dr. O'NEILL. Yes.

Chairman DOMENICI. In fact, for those who are interested, the previous year it will cut \$22 billion in appropriated accounts.

Now, the reason I raise this issue, for those who are wondering whether Senator Domenici is justified in wondering about whether this could ever happen. The President, in his 1997 allocation (and I will say to everyone that is now. That is just before an election.) has these same discretionary accounts not going down, rather they go up. And my understanding is that in this election year they go up 4.7 percent.

Now, the point I am making is that it is highly improbable that in the last year of this cycle that you will knock out \$25 billion—you will increase taxes \$25 billion. You will whack \$46 billion off of discretionary accounts. So I assume that we really don't have a balanced budget, and I would feel very, very comfortable with this approach if the President or the OMB Director would tell us what are they going to cut in 1999 and 2000 and 2001 and 2002, since this year you have to increase everything 4.7, all of a sudden in 6 years we are going to cut it \$46 billion. I would like to see how they are going to get there.

I don't think it is possible, and I don't think we will see that same scenario next year when the elections are behind us.

Now, having said that, just two questions and one observation. Is the deficit reduction that you have found, that is, the deficit in 1996, you find it to be \$144 billion using current policy assumptions. That is \$20 billion lower than the 1995 deficit of \$164 billion

and \$28 billion lower than your December projection. Is that deficit reduction the result of President Clinton's policies on balancing the budget, or is that the restraints that came about in the appropriations—continuing resolutions and the other appropriation bills this year?

Dr. O'NEILL. Of the deficit reduction since last December—that is, the change in our estimates from December to today—about two-thirds results from changes in the appropriated levels. The rest of it comes from changes, reestimates, of our own.

Chairman DOMENICI. Thank you very much. Now, I want to make this next point off my chart, which I will—I don't have a pointer, so I will have to stand up here.

Senator EXON. We will lend you one.

Chairman DOMENICI. Can I borrow it?

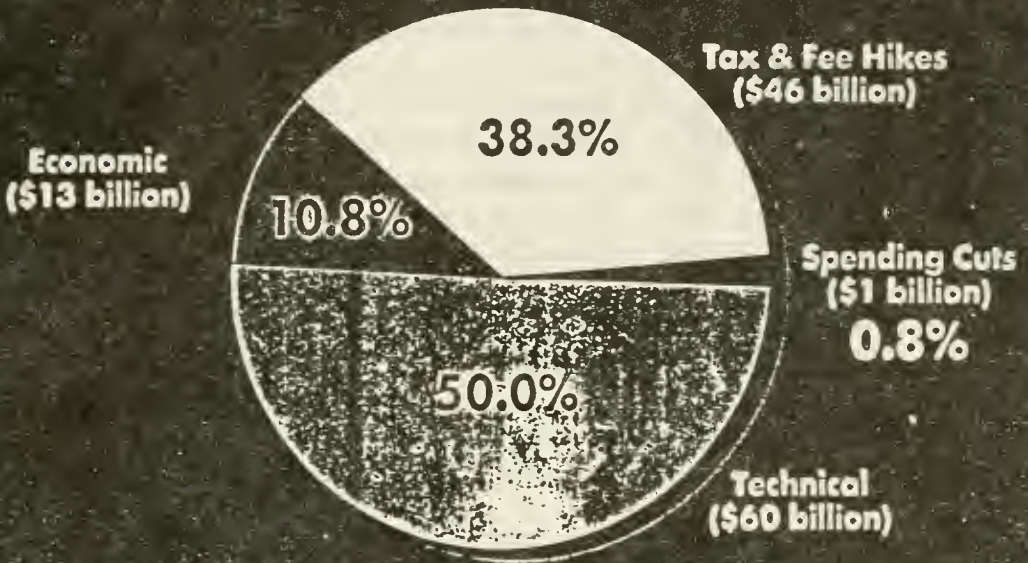
Senator EXON. Yes, Mr. Chairman.

Chairman DOMENICI. Sorry I wasn't well prepared. But I would only cite this chart for you because I hope nobody thinks our job is done. We haven't restrained any entitlement programs yet, and I had somebody go through and examine the changes in the 1995 deficit estimates from January of 1993 which was initially placed at \$284 billion. I think that was part of your chart when you were going through this group. I asked, How did we get from that \$284 billion to the active 1995 deficit of \$164 billion, Senator Exon? And I am not trying to take credit nor say somebody is taking credit when we shouldn't. I am just going to objectively tell you what I found.

Taxes and fee hikes amounted to 38.3 percent of that reduction. Spending cuts amounted to 0.8 of 1 percent. Technical readjustments amounted to 50 percent. That means you overestimated how much the thrift loan program would count, and you put \$38 billion back in the treasury and those kinds of things. So those are re-estimates, 50 percent. Economic assumptions, 10.8 percent. And so while many of us are delighted to see that from 1993 to 1995 the estimated deficit came from 284 to 164, I don't think we should think that we really have significantly reduced the underlying problem of growth in entitlement programs because only \$1 billion of that came from reducing spending below current policy.

Changes in 1995 Deficit Estimates

From January 1993's projection of \$284 billion to Actual \$164 billion



Source: SBC Majority Staff based on CBO data.

Now, I would yield at this point to Senator Exon.

Senator EXON. Mr. Chairman, thank you very much, and I appreciate the remarks that you have made. I simply want to say that regardless of how much argument we go through on all of this as to how this happened, when it happened, what effect it is going to have on the future, what effect it is not going to have on the future, we all make mistakes in projections. We make mistakes in assumptions probably more than in projections, in my view and experience here. But I think it is safe to say that if the deficit had kept going up without the corrective action, or lack thereof, as presented by the Chairman's chart a few moments ago, I am confident that you would have put the—the Republicans would have put the entire responsibility on President Clinton and his budget. He has a record of doing what he said he is going to do and, simply stated, I think that we should salute the President for what he has done.

I have some quarrels with the President's budget. I am sure that Chairman Domenici has some quarrel. But let me establish this fact now. Dr. O'Neill, isn't it true that President Clinton's 1997 budget is the first budget presented by a President that achieves balance as estimated by the Congressional Budget Office?

Dr. O'NEILL. I believe that is correct. I don't know the entire history over which we have been estimating Presidents' budgets.

Senator EXON. Thank you very much. I appreciate that.

I would like to put this chart¹ up that I have used before, and I have a question on it to help clarify the situation. This chart shows that the deficit, excluding the interest—I emphasize, exclud-

¹ See p. 330.

ing the interest we have to pay on the National debt—the chart shows that last year revenues more than offset spending for Government programs by about \$68 billion. In addition, the chart shows that CBO projects that by the year 2002 revenues will exceed program spending by about \$243 billion.

My question for you is: Can you tell us about how much of our current debt service results from deficits run up during the 1980's? How much additional interest expense—let me repeat that. How much additional interest expense would be bearing on us if the Congress hadn't enacted a deficit reduction plan in 1993 that had been demonstrated by the positive results in testimony so far and the report that you have given us today? Do you have those figures at hand? If not, I would recognize you might not have——

Dr. O'NEILL. No, I don't. And I can't make the calculation on the spot, but we would be happy to provide that.

Senator EXON. For the record?

Dr. O'NEILL. Yes.

Senator EXON. Thank you very much.

[The following was subsequently submitted for the record by Dr. O'Neill:]

From 1980 through 1989, the U.S. Government accumulated deficits totaling almost \$1.6 trillion. At the interest rates prevailing at the end of fiscal year 1995, interest on the debt would amount to around \$108 billion during 1996.

Interest savings from the Omnibus Budget Reconciliation Act of 1993 total \$7.5 billion in 1996. (See Congressional Budget Office, *The Economic and Budget Outlook: An Update*, September 1993, Table 2-2 reprinted below.)

Table 2-2.
Major Elements of Deficit Reduction Under OBRA-93 from the CBO Winter 1993 Baseline
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	Five-Year Total
Revenues						
Increase in tax rate for high-income individuals	-15.4	-22.8	-25.7	-24.6	-26.3	-114.8
Extension and increase of motor fuels tax	-4.4	-4.5	-7.4	-7.5	-7.5	-31.3
Repeal of cap on earnings subject to Medicare tax	-2.8	-6.0	-6.4	-6.8	-7.2	-29.2
Increase in taxable portion of Social Security benefits	-1.9	-4.6	-5.3	-6.0	-6.7	-24.6
Increase in corporate tax rate	-4.4	-2.8	-2.9	-3.1	-3.2	-16.4
Reduced business meal and entertainment deduction	-1.8	-3.1	-3.3	-3.4	-3.6	-15.3
Expansion of earned income tax credit	a	0.2	0.4	0.5	0.6	1.7
Other	4.3	0.2	-0.9	-9.8	-4.6	-10.8
Subtotal	-26.4	-43.5	-51.5	-60.7	-58.5	-240.6
Mandatory Spending						
Medicare	-2.1	-5.5	-11.6	-16.4	-20.2	-55.8
Federal employee retirement and health benefits	-0.4	-0.8	-2.9	-3.7	-4.0	-12.0
FCC electromagnetic spectrum auction	-1.7	-1.8	-1.7	-1.0	-1.0	-7.2
Medicaid	a	-1.0	-1.6	-2.1	-2.5	-7.1
Federal Family Education Loans	-0.6	-0.4	-0.8	-1.2	-1.2	-4.3
Veterans' benefits	-0.2	-0.4	-0.4	-0.4	-1.2	-2.6
Farm programs	-0.1	-0.7	-0.5	-0.6	-0.5	-2.5
Refundable earned income tax credit	0.2	2.0	4.4	6.1	6.4	19.1
Food stamps	a	0.2	0.4	0.8	1.0	2.5
Other	-0.3	-0.2	-1.8	-2.4	-2.5	-7.2
Subtotal	-5.3	-8.5	-16.6	-20.9	-25.7	-76.9
Discretionary Spending	0	0	-7.7	-23.0	-37.9	-68.5
Debt Service	-0.9	-3.4	-7.5	-13.6	-21.3	-46.8
Total Deficit Reduction	-32.6	-55.5	-83.3	-118.1	-143.4	-432.9
Memorandum: Deficit Reduction from Alternative Baselines						
Reduction from the CBO Uncapped Baseline ^b	-47.4	-83.2	-111.8	-147.4	-174.5	-564.4
Reduction from the CBO Estimate of the Administration's Baseline ^c	-42.0	-72.9	-94.1	-123.7	-144.3	-476.9

SOURCE: Congressional Budget Office.

NOTES: The CBO winter 1993 baseline assumed compliance with the discretionary spending limits of the Budget Enforcement Act through 1995. Discretionary outlays were assumed to grow at the same pace as inflation after 1995. See Congressional Budget Office, "An Analysis of the President's February Budgetary Proposals," CBO Paper (March 1993).

Revenue increases are shown with a negative sign because they reduce the deficit.

OBRA-93 = Omnibus Budget Reconciliation Act of 1993; FCC = Federal Communications Commission.

a. Less than \$500 million.

b. The CBO March 1993 uncapped baseline assumed that discretionary outlays would grow from 1993 appropriated levels at the same pace as inflation through 1998.

c. CBO's estimate of the Administration's baseline assumed that discretionary outlays for nondefense accounts would grow from the 1993 appropriated levels at the same pace as inflation. Defense discretionary outlays equaled the amounts requested in the Bush Administration's January 1992 budget request (with various adjustments by the Clinton Administration).

Senator EXON. Mr. Chairman, in the interest of saving time and to give our other members a chance, I will save any further questions until a later date, and I thank you for your time and consideration.

Chairman DOMENICI. Thank you very much, Senator Exon.

I think on our side Senator Grassley is next.

Senator GRASSLEY. Thank you, Mr. Chairman.

Before I ask my first question of you, Dr. O'Neill, I wanted to remind everybody, including the audience, because people are skeptical when we say we are going to balance the budget or can balance the budget, that Congress did pass a document last year bal-

ancing the budget in the year 2002, including saving medicare from bankruptcy in the year 2002, reforming medicaid, saving \$58 billion in welfare, a \$245 billion tax cut, including \$1,000 for a family of four that they would have more in their pocket this year than otherwise. We passed this, certified by the CBO that it was balanced. So if anybody wonders can Congress get the votes to pass a balanced budget, the answer is yes.

The fact is the President vetoed this. And I assume with the new economic projections, Dr. O'Neill, that not only would this—you would still certify this budget as balancing, but I assume that we would have quite a surplus in the year 2002 if the President had signed this. Is that right?

Dr. O'NEILL. Actually, the answer is probably more. We haven't made an estimate of the balanced budget act under our new assumptions. There is a timing difference and so on.

Senator GRASSLEY. OK. And that is OK with me, but at least you did certify that this budget was balanced.

Dr. O'NEILL. Yes.

Senator GRASSLEY. So Congress has passed a balanced budget act; the President vetoed it. There is kind of one person standing between this country and a balanced budget, the way I see it.

On the second point, I think that I want to follow on where our good Chairman left off, but it reminds me of the magic asterisk of the Reagan administration. And I think I have some credibility because the first budget that this gentleman chaired getting out of this committee I voted against and then he had to come back and get another budget to get the votes to get it out. And we had some game playing by that Administration to get to a balanced budget, and we never got there, obviously.

It seems to me that the points our good Chairman brought up about the President's basic budgetary proposal are similar to the same questions that I raised about the magic asterisk in the Reagan administration. It is kind of an effort, sleight of hand, to lead people to believe that there is a balanced budget when there really isn't one.

In your remarks, you stated that it would not balance as advertised, that we would instead have an \$81 billion deficit in 2002 under the Administration's basic budgetary proposal. The only way that we would get, then, to a balanced budget is what the President calls his contingent budgetary proposals, which really weren't advertised in this process, as I see it. They don't get much attention. Just like Reagan was hoping that that magic asterisk wouldn't get much attention.

In my view, this Administration then is false advertising. It has told the American people one story about its budget, when the reality, according to CBO, is really a very different story.

I might point out that even used-car salesmen have some sort of ethical standard that they have to abide by, and in this particular instance, the White House ought to have some sort of ethical standards to abide by, that when they tell us there is going to be a balanced budget, there is going to be one.

Now, my question is: Is this accurate that the President's basic budget proposals have a deficit of \$81 billion in fiscal year 2002 and not a balanced budget? Next, has the Administration provided

any details on where the \$67 billion in cuts and discretionary spending would come from in the last 2 years?

Dr. O'NEILL. With respect to the last question, there is no indication. It is the aggregate.

With respect to the first question, yes, the preferred policy without the contingency plan would leave a deficit, according to CBO estimates, of \$81 billion.

Senator GRASSLEY. So the CBO does not certify that the President's basic budget proposal gets to balance. Is that right?

Dr. O'NEILL. Well, it depends how you interpret the word "basic." Taking both parts of the plan, it balances by our assumptions. Just taking part one, which balances on the Administration's estimates, by our estimates does not.

Senator GRASSLEY. On another point, and not on a question, Mr. Chairman, as long as I still—are we going by 5 minutes by the lights there? Because I don't want to have more time than other people.

Chairman DOMENICI. Did we start that?

Senator GRASSLEY. OK. Well, then, if I have used my time, I will stop.

Chairman DOMENICI. Why don't you go with one more?

Senator GRASSLEY. OK. Well, I just want to make the point about—and here's another one where I think maybe I have a different point of view than Republican Presidents in the past. So I think I have some legitimacy in pointing out the President's defense numbers, down. I am not going to cry that they are down because I support those lower numbers. But let me suggest this, that we see the President increasing discretionary spending—I think you pointed this out very well—4.4 percent for the election year as opposed to what would have been a lower level of spending under the current budget scenario that we passed here, 3.2, I believe.

Consequently, I see the President, in order to come forth with this document, reducing defense expenditures, but increasing discretionary spending dramatically to look good during an election year to a lot of his constituents, and then having people in the military services who are going to be up here testifying, not discouraging more money coming from the Congress of the United States for defense, because they honestly are very nervous with the President's figures, leaving it to the Congress to appropriate more money, having to take it from discretionary spending to make the Republican Congress look bad because we might not want to spend money on a lot of the programs like the President wants to spend on, and yet he knows that according to his own military people he won't have enough in defense expenditures to satisfy the needs and the commitments of this country. And I think that that is another example of a lack of moral leadership on the part of this country, meaning not setting a good example, not doing what you say you are going to do or you intend to do. And I think that we are going to have to take a very close look at that.

Now, I hope that our side of the aisle will leave the defense numbers down, and I hope that we will also make sensible savings in discretionary spending so we don't have all of these savings that have to come in the out-years, as the President has proposed, and so that we can then get to a balanced budget in an honest way.

And we can do that by leaving the defense numbers where the President has them and lowering the discretionary spending and making some changes in entitlements so that we really produce a budget that is intellectually honest.

Chairman DOMENICI. Thank you, Senator.

Now, instead of having 5 minutes, I think we are going to give everybody 7 minutes because they didn't get a chance to give opening remarks. Senator Hollings, you are next.

Senator HOLLINGS. Dr. O'Neill, if you can answer Senator Grassley's last question?

Dr. O'NEILL. I am sorry. Could you please—

Senator GRASSLEY. I didn't have a question. If you want to ask a question for me and I can assume it is my question, I will let you do that.

Senator HOLLINGS. Dr. O'Neill, I take it you are not involved in this Presidential race, but you are very much involved as our Director of the Congressional Budget Office, and I take it you are very proud as our director of that office. Is that correct?

Dr. O'NEILL. That is correct, yes.

Senator HOLLINGS. And under the Budget Enforcement Act, under Title II, setting out the duties of the Congressional Budget Office, we have the various laws governing the budget of the United States. Isn't that correct?

Dr. O'NEILL. Yes, that is correct.

Senator HOLLINGS. And under Section 13-301 of the Budget Enforcement Act, it provides that the receipts or you might say expenditures and outlays of the Federal Government not include Social Security trust funds, is that correct, in estimating the deficits or surplus?

Dr. O'NEILL. Well, as an—

Senator HOLLINGS. I am asking about the law.

Dr. O'NEILL. That they be separated out.

Senator HOLLINGS. Are you familiar with Section 13-301?

Dr. O'NEILL. Not literally.

Senator HOLLINGS. Well, then, I will literally read it to you. Here it is—

Dr. O'NEILL. Yes, OK. I—

Senator HOLLINGS. Section 301(a) of the Congressional Budget Act of 1974 is amended by adding at the end of the following quote: "The concurrent resolution shall not include the outlays and revenue totals of the Old Age, Survivors, and Disability Insurance Program established under Title II of the Social Security Act or the related provisions of the Internal Revenue Code of 1986 in the surplus or deficit totals required by this subsection or in any other surplus or deficit totals required by this title."

Now, that is the provision of the budget law. Isn't that correct?

Dr. O'NEILL. Yes, and we do maintain it as an off-budget item; we maintain the distinction.

Senator HOLLINGS. I am not talking about off budget. I am talking about one budget, whether it is balanced or not. I don't want it off or on. What I want is a budget. For example, we had the very embarrassing situation where on October the 18th of 1995, talking about that so-called balanced budget that the Senator referred to, on October the 18th you wrote our distinguished Chairman—and

I won't read the entire letter, but you quote a small budget surplus in the year 2002. Thereupon, when notified of the law of the budget itself, you then on October 20, to the Senator from North Dakota, Senator Kent Conrad, you said, "It would project an on-budget deficit of \$105 billion in 2002. The letter you received yesterday incorrectly stated these two figures." So you came from a small surplus to a \$105 billion deficit. Isn't that correct? Do you dispute your own letter?

Dr. O'NEILL. No, I don't dispute the letter.

Senator HOLLINGS. All right.

Dr. O'NEILL. I don't have it in front of me and don't recollect the precise language—you know, I sign very many things—but I understand basically what you are getting at.

Senator HOLLINGS. Yes; well, and the fact is now that neither budget is balanced. They are both over \$100 billion in deficit, whether you take the President's or you take the Republican budget. We haven't gotten a balanced budget.

You see, what happens is, as is stated here, in a budget that has been worked upon here for the last several weeks, the distinguished Senator from Louisiana, Senator Breaux, said—got a bipartisan group and you looked at this particular budget proposal, it used Social Security trust funds in violation of the law over that 7-year period, or now 6 years, \$600 billion and also adjusted the CPI but then took the credit totally for the deficit of that adjustment, whereby half of it would go to Social Security if you get a lower CPI.

So what we are doing is some or the other we just can't talk sense and we can't conform to the law. Don't you remember the President saying in his dramatic State of the Union earlier this year we are a government of laws. If we who are enacting budget laws don't have any respect for them, no wonder the people don't have any respect for this charade that goes on up here.

What happens, Dr. O'Neill, is—you are familiar with this just last week talking about the highway trust funds, but supposedly untapped funds are actually an accounting figment, end quote.

Now, you see, that is what is going to happen to the poor kids, the kiddie bank. The chairman of the House Budget Committee in this morning's news is quoted as saying,

Once again we are dipping into the kiddies' piggybank, the kids' piggybank, when you use highway trust funds.

You see, in 1986 we passed the taxes for highways and not for deficits otherwise. Similarly with respect to the Social Security, which is in surplus—in surplus, mind you me. But we are putting it into deficit and taking credit for balance. Don't you think that is a vicious kind of budget process as the Director of a budget?

Dr. O'NEILL. Well, we have always maintained we really treat the budget as a unified budget because it—

Senator HOLLINGS. What do you mean unified? How do you treat it under the law?

Dr. O'NEILL. I can't really address the legal distinctions, but I believe as a matter of practice—and as a matter of reality—the Social Security receipts are blended with other receipts and go—

Senator HOLLINGS. Not under the law, they are not blended with other receipts. That is specifically what Section 13-301, giving you your authority, forbids.

Dr. O'NEILL. We maintain the accounts so that one can examine it and see. I——

Senator HOLLINGS. You maintain the accounts in violation of the law.

Dr. O'NEILL. No; to fulfill the requirement of the law, we show the deficit both as an on-budget deficit and as a total deficit. If we did not count——

Senator HOLLINGS. What is the difference? Which is which? Which one is in conformance with the law?

Dr. O'NEILL. I believe that both are in conformance with the law. The on-budget deficit, if we were not to count the Social Security surplus——

Senator HOLLINGS. If you were not? That is what the law requires: thou shalt not.

Dr. O'NEILL. Then what we would be facing this year would be a deficit of \$209 billion.

Senator HOLLINGS. \$209 billion.

Dr. O'NEILL. Not \$144 billion. And we would have to come up with the difference. Now, I——

Senator HOLLINGS. The fact is, Dr. O'Neill, the Federal debt held by the public you don't consider Social Security recipients public. In other words, you don't show the debt owed to the Social Security Trust Fund in your little chart. The Federal debt held by the public, Civil War, World War I, World War II, those who have really trusted the trust are not public as far as you are concerned because you don't show the debt owed the trust funds there, the Highway, the Airport and Airways Trust Fund, or specifically Social Security and Medicare.

Dr. O'NEILL. They are not part of the publicly held debt.

Senator HOLLINGS. That is fine accounting.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you.

On our side, Senator Grams, you are next.

Senator GRAMS. Thank you very much, Mr. Chairman.

Dr. O'Neill, welcome. I would just like to follow up a little bit quickly, if I could, on the Senator from South Carolina's line of questioning. When we talk about using these trust funds, we are not actually using the trust fund dollars, are we? The way the law was written was smoke and mirrors by a Democratic Congress that allowed them to use the surplus without breaking the law, and that is, they put in IOUs and put the dollars into what you call the unified budget or the trust fund. I mean, we are arguing semantics here.

I would agree. I wish we wouldn't be doing this. I wish these trust funds would be held somewhere else, where there was actually dollars there or goods to back them up. But there is not.

You know, I am kind of disappointed and amazed, maybe, that we have only heard the word "extremist" budget only mentioned once so far this morning, and I am sure we are going to hear it again, though, before this hearing is over, about the Republicans and their extremist budget

But I want to also look at that chart where it says before Clinton and after Clinton. I think it would be more realistic if we said before a Republican Congress and after a Republican Congress.

I guess my question is: Who really drives the deficit train? When we talk about the 1980's, they point to the deficits as being the problem of Ronald Reagan when I think it was the Congress who passed the laws, signed the checks, and did the spending. But is the deficit reduction that we see on the board now, looking at \$144 billion, reportedly, using currently policy assumptions, is that reduction a result of President Clinton's policies or what Congress is doing?

Dr. O'NEILL. It is very difficult to assign to a person a change——

Senator GRAMS. The President only recommends; is that right? He doesn't pass the budget.

Dr. O'NEILL. That is true, but there are so many different forces that have an impact on the deficit that you could not really identify a single individual. We have done an analysis of the reasons for the decline in the deficit between 1992 and 1995, and I believe that what our results show was that about half was due to improvement in the business cycle. In 1992, the country was still in the early stage of recovery. The unemployment rate was 7.5 percent. Growing out of the recession accounts for about half of the decline. Then, looking at the other half, about half of that is accounted for by the tax increase in 1993. And the remaining quarter of the decline is to a large extent due to restraint in discretionary pendings. Declining interest rates are also a factor; so you might want to thank Alan Greenspan for that.

But, no, I think you really can't pick out an individual or even a single thing. These analyses are awfully hard to do.

Senator GRAMS. I want to follow up also on the Chairman's question about discretionary spending and the large cuts, \$22 billion and \$46 billion in the last 2 years of the President's budget. Is this realistic? Would any Congress—do you believe this can be done?

Dr. O'NEILL. The reduction in discretionary spending at the end?

Senator GRAMS. I know you have to balance the budget because the numbers are there, and if Congress would enact this proposal by the President, along with his triggers, it could balance. But is this realistic? Have you seen this happen?

Dr. O'NEILL. Well, political forecasting is something I stay out of. The actual implementation of any budget is dependent on the action of future Congresses and Presidents. That is something that we have no way of predicting.

Our estimates are confined to saying, if implemented, this is what a given budget plan would save or cost and nothing more. We don't guarantee that something actually will happen.

Senator GRAMS. So unless we all go on record and——

Dr. O'NEILL. We haven't reached that level of power.

Senator GRAMS. Let's be very precise. Without the gimmickry of the trigger, would the President's budget be in balance in the year 2002 if you didn't use the trigger?

Dr. O'NEILL. Without the trigger, it would not.

Senator GRAMS. If not in balance, then there would be no fiscal dividend, is that correct, that we are looking at?

Dr. O'NEILL. Well, the fiscal dividend would be smaller by some amount because there would still be substantial deficit reduction. It would not go all the way, and, therefore, it would be somewhat different. Adjusting it for that amount of deficit reduction would be difficult to do. But it would be lower than the current fiscal dividend.

Senator GRAMS. Therefore, what would be your estimate, then, of the President's deficit in the year 2002 if we didn't use the triggers, again?

Dr. O'NEILL. In a way, that is not fair because the President did in fact submit something that came in two parts. But if we were just shown the first part, we would say that there would be an \$81 billion deficit. But we did give full credit for the fiscal dividend in that estimate. So the deficit would be something more, although since the size of the fiscal dividend is actually not that huge, making distinctions between one amount and another amount as a practical economic matter is somewhat difficult.

Senator GRAMS. Can we lower the deficit through just shaving discretionary spending, realistically, over the next 7 years, if we just take it out of discretionary?

Dr. O'NEILL. It becomes increasingly difficult to do that. It is not that it would be impossible to freeze discretionary spending over the 7 years. But if one tried to do it going out over the next 40 or 50 years, I would say that would become impossible because what would be left would be very small.

In real terms, a freeze would amount to a reduction in the purchasing power of programs of 25 percent by 2006. Now, that is something that could be done, but it is a matter of the preferences of the Congress, the President, and the public.

Senator GRAMS. One other question. I wanted to look at your chart there. The Federal debt held by the public you said shortly will be equaling the highest level ever, and that is referring to the highest level of World War II, and we are getting close to, in a few years, equaling that level of public debt. How are we going to repay this public debt? Where does the money—I mean, we are supposed to be holding it in trust funds as being noted, but as we know, that is a liability on those trust funds.

Dr. O'NEILL. We really have to run primary surpluses of some magnitude in order to reduce the public debt.

Senator GRAMS. In our general budget?

Dr. O'NEILL. Yes.

Senator GRAMS. Because that is the only source of repaying these loans that we have taken from Social Security and the other trust funds?

Dr. O'NEILL. Oh, no. The publicly held debt does not include what is owed—what is in the trust funds. This is what is held by individuals, both in the United States and abroad. These are treasury bonds that have actually been sold, and the United States is responsible. We pay interest on this debt to the holders of the debt, which is why it has practical consequences affecting savings and investment and so on.

Senator GRAMS. Thank you very much, Dr. O'Neill.

Senator GORTON [presiding]. Senator Lautenberg is next.

Senator LAUTENBERG. Thanks, Mr. Chairman.

Just a couple of things. First, I want to reiterate the welcome to Senator Wyden and Senator Grams. You see how tranquil and how logical the debate is here, and you are going to enjoy this. Just make sure you wear a mask and protect yourself, because we have heard that the President perhaps has a lesser standard of truthfulness than used-car salesmen. I am sure the used-car fraternity will be writing to us pretty soon. I guess if that is a euphemism for sleaze, then that goes on the record here that anybody who sells used cars is a sleazeball. And it is amazing to me to hear references to the fact that these deficits were suddenly managed by the Republican Congress, except their proposals have not been signed into law, and the President's accomplishments are very clearly on the record. I think it is important to note that for 12 years the Reagan and Bush administrations didn't do an awful lot about the deficit except increase it. They racked up \$2.3 trillion worth of debt and left it for us to deal with. In fact, if we didn't have to pay interest on that debt in these 12 years, the budget would have been in balance in fiscal year 1996.

Is that a true statement, do you know, Dr. O'Neill?

Dr. O'NEILL. I believe——

Senator LAUTENBERG. If we didn't have to pay the interest on the debt that we currently have, the budget would have been balanced in this year.

Dr. O'NEILL. Yes, that is true.

Senator LAUTENBERG. Interest in the 12-year period, and I think you did already admit that President Clinton was the first one to propose a balanced budget on our records. Never before has it been proposed, and you said that you weren't sure how far back it went, but you did agree that at least contemporaneously that that was the case.

Dr. O'NEILL. I don't believe it is proposed. It is what CBO estimated would actually balance.

Senator LAUTENBERG. So that is pretty good. And so the question isn't any longer whether or not we are going to balance the budget. The question is how we are going to balance it. And the President did exactly what the Republicans demanded he put out, a 7-year budget that was scored correctly as having achieved the goal by CBO.

I would ask you this, Dr. O'Neill. You have warned about the growth of entitlement programs in the past, but you have focused your attention on entitlement programs like medicare and medicaid. But we are, however, likely to spend over \$4 trillion in tax expenditures over the next 7 years. Now, the Republican budget actually increases spending on tax breaks by a net of \$19 billion in 7 years. Isn't it fair to call those tax breaks entitlements, having a program that specific, that long in duration?

Dr. O'NEILL. Actually, I don't know the exact numbers about tax expenditures.

Senator LAUTENBERG. Do you think we can find some savings in those areas?

Dr. O'NEILL. Well, undoubtedly one can find—you know, there are always ways of——

Senator LAUTENBERG. Sure, right. I mean, if we can find savings off the backs of the elderly in this extreme Republican budget, this

extreme budget we are reviewing—the extreme budget. That if we again take it off the backs of the elderly and the impoverished in terms of medical or health care, then couldn't we also find some of these savings in the tax expenditures——

Dr. O'NEILL. Certainly tax increases of any kind are one way that deficits can be reduced.

Senator LAUTENBERG. Not increases, not tax increases. Tax decreases.

Dr. O'NEILL. Tax increases.

Senator LAUTENBERG. Tax expenditures, yes. OK.

Chairman DOMENICI [presiding]. An increase. You are right.

Senator LAUTENBERG. Yes, yes, that is right. The Republican budget offer includes now \$168 billion in medicare and \$85 billion in medicaid——

Chairman DOMENICI. Which budget are you referring to now?

Senator LAUTENBERG. The final Republican budget.

Chairman DOMENICI. Last year's?

Senator LAUTENBERG. The one you submitted——

Chairman DOMENICI. Not 1997.

Senator LAUTENBERG. The one that you have submitted——

Chairman DOMENICI. 1996.

Senator LAUTENBERG. You haven't submitted one yet. It had \$177 billion in tax breaks. Isn't it true that if we had lowered the tax breaks, we also could lower the cuts in medicare and medicaid?

Dr. O'NEILL. Well, obviously, yes.

Chairman DOMENICI. Senator, could I just say——

Senator LAUTENBERG. Mr. Chairman, in fairness, if you want to answer the questions, take the witness seat.

Chairman DOMENICI. I am not going to answer the question.

Senator LAUTENBERG. But as a courtesy, I really think that we ought to be able to have an exchange between——

Chairman DOMENICI. Sure you may. Let me just suggest that it has always been the practice that the CBO Director didn't tell us how to do things. They gave us actual examples and analysis, and they didn't set policy for us. Now——

Senator LAUTENBERG. That was before——

Chairman DOMENICI. And I am not sure you are asking her to set policy, but I think she can give you a factual analysis, but she can't tell the Congress what they ought to do.

Senator LAUTENBERG. No, but it is certainly, I think, fairly obvious that if savings are going to be achieved, that they can be achieved in many ways. And I just want to hear whether the Director thinks that tax expenditures also could be one way to achieve a budget balance and a reduction in the tax expenditures. The answer I think she gave was yes.

I also, Mr. Chairman, want to comment on the chart that was up, your beautifully colored chart was there, in which, as you know decried the President's efforts toward getting us to the balanced budget, to the low budget deficit that we anticipate for this year, you had \$1 billion worth of savings on entitlements and kind of described it as de minimis. Would you say that is a fair characterization of what you said?

Chairman DOMENICI. No; I said from 1993 to 1995. I did not speak about 1996. In that year, technically there is \$1 billion in

deficit reduction coming from cutting programs. That is derived from CBO numbers, not mine.

Senator LAUTENBERG. OK, and how modest a number that was, as you have described it. I would just like to mention that in 1994, for instance, we had \$3.5 billion worth of Midwest flood relief, which I think some of the members of this committee might have voted for. We had \$2.7 billion in 1994 for the Los Angeles earthquake, another disaster relief, and \$4 billion, over \$4 billion in 1995. I just want to point out that some of these ought to be included in recognizing the accomplishments of this Administration in terms of managing the budget. We gave the Coast Guard an extra \$1 billion in 1995, and there is more to add to that list.

So it was technically far more than \$1 billion worth of savings that could be considered in terms of evaluating the budget deficit.

Thank you.

Chairman DOMENICI. Thank you, Senator.

I think on our side Senator Gorton is next.

Senator GORTON. First, Mr. Chairman, to the extent that I have an opening statement, I would like it to be that I am not sure that any of us are going to make much progress, or even probably any great number of political points by repeating some of the debates over the course of the last 2, 3, or 4 years. I have every hope and I think some expectation that this year there is going to be a real attempt to meet somewhere in the middle. In fact, there has been considerable budget movement both by the President from his original position of last year and by the Republican leadership from its original position of last year, which I supported. I think it made for sound fiscal policy towards something which can meet the requirements of a government which has one party with a majority in Congress and another party controlling the Presidency. And if we are actually to do something for the country, it only gets done when there is a form of agreement, and I believe that the proposals that the Chairman, Senator Domenici, is going to submit to this committee this year are going to be relatively appealing.

The Senator from North Dakota and I and some others have been a part of a bipartisan group attempting to work toward this middle ground for some time. I think those proposals are going to merit careful consideration by people on both sides, and I hope that much of what we do from now on will be an attempt to actually accomplish something for the American people rather than to make debating points.

So I just have a couple of questions on another matter, and they really are questions, and I will let you answer them, Dr. O'Neill. Yesterday, the House of Representatives passed a bill taking four trust funds off budget. I understand there are more than 160 trust funds all together.

What is the impact of taking a trust fund off budget in the real world?

Dr. O'NEILL. There is not necessarily any impact at all, but in the case of an appropriated account, it does free it from the stringencies of the budget agreement and, therefore, it is exempt from the caps.

Senator GORTON. So a law taking any trust fund off budget doesn't affect the amount of money collected by agencies of the Federal Government?

Dr. O'NEILL. No.

Senator GORTON. Or directly affect the amount of money spent by agencies of the Federal Government?

Dr. O'NEILL. Well, it could. Since they are released from the stringent requirements of the Budget Act and the caps, they would be free to spend more.

Senator GORTON. So if a trust fund is running a surplus, it could end up spending more and there would be a comparable increase in the deficit in all the other accounts?

Dr. O'NEILL. That is a possibility, and a danger of doing this.

Senator GORTON. So we could, I suppose, create trust funds for every single spending program of the Federal Government and pretend we had no deficit?

Dr. O'NEILL. I guess you could.

Senator GORTON. Is it appropriate to ask you whether or not the bill taking four trust funds off budget is sound fiscal policy or helps explain to the American people what the fiscal problems of the United States are?

Dr. O'NEILL. No; I think it is, not a good idea.

Senator GORTON. The second part of it is certainly a factual question. The more complex, the more separate off-budget trust funds there are, the more difficult it is for the American people and even Members of Congress to understand the overall fiscal impact of their actions, is that not—

Dr. O'NEILL. I think that is true. It does obscure to some extent what actually goes on, or it can.

Senator GORTON. OK. Dr. O'Neill, thank you on that. It seems clear to me that actions of this sort represent a very real step backward, to favor some kinds of spending over other kinds of spending without a rational evaluation of their relative impact and their relative contributions to our economy as a whole. And they certainly won't make your task in explaining all of this to us any easier, will they?

Dr. O'NEILL. No.

Senator GORTON. Thank you, and thank you, Mr. Chairman.

Chairman DOMENICI. Thank you, Senator.

Senator MURRAY?

Senator MURRAY. Thank you, Mr. Chairman, and I join my colleagues in welcoming you, Dr. O'Neill, to this committee and echo the sentiments of my colleague from Washington, Senator Gorton, that I hope that this year we can reach a balanced budget. I was pleased to see that CBO believes the President's fiscal year 1997 budget proposal will balance by 2002 and, in fact, that there would be a surplus, and I think that is important as all of us continue to work towards achieving a balanced budget. I think that shows that we can get there, and if we can set some of our differences aside and reach some consensus, I think that would be good for this country.

Let me ask a little more specific questions than we have had to this point, because one of my top priorities is education and working to ensure that all of our young people today are well prepared

to compete in the ever changing global marketplace that they are going to be entering. And I was pleased to see a USA Today poll recently that showed that 92 percent of Americans support continuing 1995 levels of Federal funding for education. People do not want us to reduce education funding.

Dr. O'Neill, in your testimony you talk about the budget impact of imposing a nominal freeze on discretionary spending, and you note that this freeze in 2002 would be along the lines of last year's Republican budget. In terms of education funding, can you tell us what this nominal freeze would amount to?

Dr. O'NEILL. I can't tell you for any individual program because they are in most cases appropriated annually, so it would depend. Any individual program could increase—as has happened this year, for example, in the case of the National Institutes of Health—while others decrease.

Senator MURRAY. What about education? You can't give me a general——

Dr. O'NEILL. That is up to future Congresses because the spending would be appropriated. It is nothing automatic. The plans assume if every program was frozen——

Senator MURRAY. If you did an across-the-board freeze, if you——

Dr. O'NEILL [continuing]. Then it would be a 25 percent cut.

Senator MURRAY. It would be a 25 percent cut?

Dr. O'NEILL. A literal freeze at 1996 levels based on the rate of inflation that we project.

Senator MURRAY. In terms of inflation in real dollars, we would be looking at a 25 percent cut to education?

Dr. O'NEILL. In purchasing power, yes.

Senator MURRAY. So that would be a very real effect on many of our school districts and schools across this country?

Dr. O'NEILL. To the extent that they depend on Federal funds.

Senator MURRAY. And they do. Believe me.

More specifically, let me just mention the School-to-Work Program. I just did a series of town-hall meetings across my State to talk about our young people and what was working, and the program most often mentioned to me was the School-to-Work Program because it is actually providing our students a way to get into employment in the future. And the Federal funds that we have appropriated in the past have been absolutely critical to the infrastructure and their ability to move forward on this.

Does CBO have any indication if a nominal freeze at 1996 levels would delay that implementation of school-to-work or hinder our State's ability to set up any kind of infrastructure?

Dr. O'NEILL. Again, I can't address what would happen to an individual program.

Senator MURRAY. But you are saying that it would be a 25 percent cut, or if we eliminated it altogether, that would obviously have a dramatic impact. But you are saying it would at least be a 25 percent reduction?

Dr. O'NEILL. Well, not necessarily. If it is a program that is protected, it could even get an increase.

Senator MURRAY. If it is an across-the-board cut, though, it would be——

Dr. O'NEILL. If it is an across-the-board cut, that would be.

Senator MURRAY. OK. Let me focus on medicaid, then, because that is the other thing that I heard critically affected particularly children in my State, and I know it does across the country. Washington State's health care experts have told me that they can still serve the children in our State and the elderly if we cut medicaid by \$55 to \$59 billion as long as the growth rate is consistent with medical inflation. And I believe that your projected growth rate for the Medicaid Program has been adjusted since December to ultimately see slower growth both in 1997 and 2002.

In 2002, the projected growth would be about 9.9 percent, according to your figures. I was curious what your specific assumptions about the Medicaid Program were as you put those together. Were you looking at the National Governors' Association plan, at the Republican plan that has been proposed? What did you base your assumptions on?

Dr. O'NEILL. Our so-called baseline projections are under current policy, not based on a change in policy. And those are based on our analysis of recent spending trends and our projections based on what information we can glean from States on their plans.

Senator MURRAY. So you project the growth will be 9.9 percent based on the current program.

Dr. O'NEILL. We have been projecting about 9 percent to 10 percent a year growth in medicaid.

Senator MURRAY. OK. So that would change dramatically; that growth would be reduced dramatically if we looked at, for example, the National Governors' Association plan.

Dr. O'NEILL. Yes. The growth would slow.

Senator MURRAY. Are you assuming in your assumptions that States will be able to reduce their share of the in-State and Federal medicaid partnership? Do you look at what States are able to do as well or just simply—

Dr. O'NEILL. No, we do the estimates. We don't do individual analysis of a State's ability. States differ considerably from one to another.

Senator MURRAY. Thank you, Dr. O'Neill. And, again, these are two critically important programs for our young people today, and I think we have to be very careful as we move forward, all understanding that we need to move to a balanced budget but as we do, we are going to dramatically impact the lives of young people today.

Chairman DOMENICI. Thank you, Senator.

Senator Wyden, you are next.

Senator WYDEN. Thank you very much, Mr. Chairman and Dr. O'Neill. Let me start by offering up that I think it seems that there are signs of progress here. The American people are not likely to be turning cartwheels yet because it is obvious that so much more needs to be done, but I am interested in seeing the parties come together in trying to get a strong bipartisan package that really does cut spending. I want to ask you about some of the similarities that seem to turn up as I look at these budget proposals.

The 1996 budget resolution, for example, includes caps on discretionary spending of about \$514 billion in 2002. How does that compare to the level in the President's budget for that same year?

Dr. O'NEILL. In the year 2002, with the contingent piece, it is about \$15 billion higher. The President's discretionary level would be \$530 billion. The budget resolution called for \$515 billion.

Senator WYDEN. I offer this up because it does seem there are differences that the parties are moving together and it is obvious that the discretionary spending cap is going to be an important part of the debate. I look at that and I see progress.

With respect to tax cuts, I will tell you, having been home pretty much for 6 months non-stop, that I found citizens taking a pretty dim view of very large tax cuts before the budget is balanced. In the balanced budget proposal I put out, I said you ought to have only one tax cut at this point and that would be the one for college and vocational payments which is in the President's budget and I have heard many Republicans speak of that in a very sympathetic way, as well.

What would happen if the tax cuts under these budgets, both the President's and the Congress's, were essentially, other than perhaps the one for education, and you all have run some good numbers on that, what would happen if the tax cuts were put off the table at this point?

Dr. O'NEILL. Obviously, those are a factor that would enable the economy to run surpluses and retire the debt faster with the reductions that are proposed for the various spending programs.

Senator WYDEN. I understand that, and that is the obvious, but would there be any other beneficial effects based on the kind of evaluations you have done at this point?

Dr. O'NEILL. Of eliminating tax cuts? It depends on what the exact cut is. Some have economic effects; some have none. Otherwise, if it is in the case of tax—

Senator WYDEN. I would be interested in working with your office to examine that further, because it seems to me that people are saying, we need the fiscal discipline first. In the case of education, because of the global economy, it seems to me that is all important. That is why I have indicated I would support just one. But I would like to look and have your office do some further analysis of holding off on tax cuts for 3 or 4 years until we get the kind of fiscal discipline that the public wants, because I do not think, and your answer to me really implies it, not all tax changes are created equal. That is why I have supported one, and I would like to work with your office some more on that.

Let me ask one additional question. As you look at the testimony that you all prepared for today, what really leaps out at you is that we need a great deal more analysis about the effects of the baby boom populating aging. Could you give us a little bit of a preview of what we are going to be getting from you next month, because at this point, when you are talking about a long-term budget assessment, and we are going to have to make those judgments on this committee, we are going to have to have some of this data. If it is coming out next month and you could give us a few highlights of what we are going to get, I think that would be helpful.

Dr. O'NEILL. Some of that is in the prepared statement; we do have a brief summary of what is coming out in our report. The basic premise is that the retired population is going to double over the next 30 to 35 years. On the other hand, the working age popu-

lation is not going to grow very fast as all. As a consequence, there is going to be an increase in the number of retired people per worker. Since current workers' contributions are what go to pay current Social Security, medicare, and medicaid, that is the basis of the problem.

Senator WYDEN. Do you look, for example, at the possibility that birth rates are going to be fairly stable in the years ahead? People may live longer and feel better, as the trends certainly indicate. That may make it more attractive for older people to keep working on a voluntary basis and pay into retirement programs. Do you all look at that?

Dr. O'NEILL. We do. These projections include assumptions about increases in longevity and changes in birth rates. We have examined the scenario under different birth rates. But certainly well into the next century, we have a pretty good idea of how many retired people there will be and how many working-age people there are going to be. So that part of the estimate is less problematic.

Senator WYDEN. Again, I would like to see this further with you, but it seems to me if birth rates are going to be fairly stable and people are going to be living longer and feeling better and the nature of work is changing with more of it being information driven, we may see a trend where more older people will say it is attractive to keep working and pay into retirement programs rather than retire early, as has so often been the case. I will look forward to seeing your analysis, but I think that this is just central to being able to make these long-term assumptions.

Mr. Chairman, I thank you.

Senator GRAMS [presiding]. The Chairman has just stepped out for a moment, but Senator Conrad is next.

Senator CONRAD. Thank you. I also want to add my voice of welcome to Senators Wyden and Grams to the Budget Committee. Hopefully, there will be days where we have an even better discussion than the one we are having today. But nonetheless, I am glad that you are with us.

First, I wanted to address some of the statements that were made by the Chairman in his opening remarks, being critical of the President's budget on two scores. First, he criticized the President's budget and the level of domestic discretionary spending in the last year of the President's budget, suggesting that the domestic discretionary cuts were too large.

I would simply point out for the record that the Republican balanced budget plan had \$16 billion of cuts over and beyond what the President's plan calls for in the final year. So I am a little surprised to hear them levying the criticism of the President's plan when their own plan had \$16 billion more of cuts.

The second criticism that was leveled at the President's plan by the Chairman was the notion of a trigger on the tax cuts, because I have a sheet from the last offer the Republicans made at the White House that does precisely the same thing. It seems to me some of these criticisms are highly questionable with respect to the President's budget.

Dr. O'Neill, I would ask you if you agree with this statement. The dramatic improvement since last January—the improvement they are referring to is in the budget deficit—is largely a result of

the enactment in August of a major package of tax increases and spending cuts, the Omnibus Budget Reconciliation Act of 1993. This is a CBO analysis in January of 1994 with respect to the deficit outlook. Would you agree that the 1993 Act, which had tax increases and which had spending cuts, made a significant contribution to deficit reduction over this period?

Dr. O'NEILL. Yes, as I said before.

Senator CONRAD. So we have had significant deficit reduction under the leadership of President Clinton. I think that is just a factual matter.

But let me go to a different point, because some of your testimony concerned me and some of the discussion of our colleagues also concerned me, the question of trust fund surpluses being counted as part of the unified budget and whether or not it matters. Our new colleague, Senator Grams, talked about it as being a matter of semantics.

I do not think it is a matter of semantics at all. I think it is a matter of fact about how one treats trust funds and whether or not they matter and whether or not the law means something. The law is very clear. The law specifies that for the purposes of determining whether or not we have balanced the budget, we do not count trust fund surpluses.

I would ask you, Dr. O'Neill, do you consider it a balanced budget if in order to balance it requires the use of Social Security Trust Fund surpluses?

Dr. O'NEILL. Yes. The deficit that we calculate uses all of the Social Security receipts even though there is a current account surplus, and I believe that is by agreement—the President does it this way, the budget committees do it the same way.

Senator CONRAD. So you believe that represents a balanced budget?

Dr. O'NEILL. If a budget was balanced only because of the Social Security surplus, so-called, I would say that it was balanced, yes.

Senator CONRAD. You would?

Dr. O'NEILL. Based on the realities of the Social Security System and the way it operates fiscally.

Senator CONRAD. Let me ask you this. If you were running a company, a private company, and the company was not operating in the black by, let us say, \$500,000, but the company declared itself to be running a balanced budget by taking \$500,000 of the retirement funds of its employees, would you consider that an appropriate way to achieve balance in the private sector?

Dr. O'NEILL. No, because trust funds are different in the case of a company.

Senator CONRAD. Oh, they are?

Dr. O'NEILL. Yes.

Senator CONRAD. In what way is it different to take the retirement funds of people in the public sector and throw those into the pot to call it a balanced budget? How is that different? Would you explain that to me?

Dr. O'NEILL. The trust funds in the Government are actually paper entries.

Senator CONRAD. So it does not mean anything when you are in the public sector, but in the private sector, we consider it inviolate?

Dr. O'NEILL. I do not think that I am just being personally cynical. I believe that what I am saying is the actual reality of it, that the trust funds really exist as a paper entry. This is not——

Senator CONRAD. No, I am asking you the question.

Dr. O'NEILL. It would be a different answer——

Senator CONRAD. That may be the way it is done, but is that right? Do you think that is right?

Dr. O'NEILL. The part that is not right is that perhaps we have not really squared enough with the public about the actual facts of the situation with Social Security, which is really a pay-as-you-go system. There is a tax that provides receipts and those go into the Federal hopper and they are part of our general receipts.

Senator CONRAD. Let me just say, first of all, the law is very clear with respect to what we do. We are supposed to balance without counting Social Security surpluses. We changed the law in order to achieve that result because we believed, those of us who voted that way, that we were engaged in a fraudulent scheme here.

I just say to you, remember the Reverend Jim Bakker?

Dr. O'NEILL. Yes.

Senator CONRAD. Remember, Reverend Jim Bakker went to jail. Do you know what the charge was? Do you know why he was in a Federal facility?

Dr. O'NEILL. I assume he absconded—if I can recollect, it had something to do with——

Senator CONRAD. He raised money for one purpose and used it for another. That is fraud. That is exactly what we are engaged in on a grand scale here. We take money on one basis, use it on another, and the result is we have really misled the American people. That is why we changed the law to assert that if establishing whether or not you have a balanced budget, you cannot count Social Security surpluses. You seem to believe that it is OK. I do not think it is OK. I think it is one of the serious problems we have here.

All of this talk about these are balanced budgets—the President's plan is a balanced budget, I do not believe it. The Republican's last plan was a balanced budget. I do not believe it. None of them are balanced budgets. It is this kind of misleading talk in Washington that creates serious problems in the country because it understates the magnitude of the problem we face.

My time has run out, but I really believe that if we were all being square with the American people, we would say the deficit is substantially higher than we show it being on a unified basis because you would not use Social Security Trust Fund surpluses. Nobody should be doing it.

My time has expired.

Senator GRAMS. Thank you very much, Senator Conrad.

Senator Boxer?

Senator BOXER. Thank you very much, Senator Grams. Look how quickly you have gone to the head of the class. I think this is a wonderful achievement. Welcome to the committee, and I welcome my colleague who has gone on to other things, Senator Wyden.

I will try to keep my remarks below the 7 minutes because I do not want to reiterate too many of the things that have been said, although I cannot promise that.

Dr. O'Neill, thank you for being candid with us. I believe we have a good story to tell about the macro picture, the big picture. As an economics major in college, things have changed a lot since then. The bottom line, however, is still true. You need jobs. You need a Federal Government that responds to problems. You need fiscal responsibility. I think we are moving in that direction under this President.

There is still economic anxiety out there and I want to talk a minute about that. It is not directly related to your job, but I think it is important that you hear what I think and what others are saying. People are anxious today. They are anxious about their paychecks. They are anxious about health security. They are anxious about pension security. And they are anxious about the ability to educate their children.

I think we Democrats recognize that and we are going to push as hard as we can, every day that we can, and on every occasion that we can to remind all of our colleagues that it is important to address these factors, these factors that I suppose you could call the micro-factors, what really impacts everybody on an individual basis.

Today, happily, we have some bipartisanship on the floor. I do not know how long it will extend, but at the moment, we have the Kassebaum-Kennedy bill addressing one of those insecurities.

But I think there is good news on the larger scale. I am going to state those things perhaps in a little different way. The economy did not dip into a recession in 1995. No recession appears to be on the horizon. The consensus outlook for the coming year is that growth will be moderate, interest rates will remain stable, inflation will remain low, and the deficit will decline for the fourth straight year. Am I correct in stating those facts?

Dr. O'NEILL. Yes.

Senator BOXER. I would also note that the gross domestic product grew by 4.1 percent in 1994, the highest annual gain since 1984. All of these gains have been made despite the hues and cries and warnings of dire consequences heard in this particular committee, sounded by my Republican friends when the Democratic Congress passed the President's 1993 deficit reduction bill without one Republican vote.

So things are going well in the large picture. We now have, as Senator Exon has pointed out, what we call a primary surplus. When you take away interest on the debt, we have a primary surplus. Revenues exceed program spending, as the chart shows. Further, CBO's scoring suggests that this primary surplus will continue to grow. Am I correct in that? If you take away the interest on the debt?

Dr. O'NEILL. Under the proposals to balance the budget, it does.

Senator BOXER. Correct.

Dr. O'NEILL. But under our baseline, it does not.

Senator BOXER. Correct, on the proposals to balance the budget.

Two other important factors which highlight the Nation's sound economy are new investment and job growth. Eight million jobs have been created during President Clinton's tenure and the vast majority of these jobs—90 percent of them—were created in the private sector, and I want to talk about my home State. Mr. Chair-

man, when I came here, my home State was in deep, deep, deep trouble, and it is the largest State in the union. If it was a country, it would be the eighth largest country in the world.

Let me tell you about my State. My State has been the beneficiary of some of this new investment in job creation. In tandem, new investment and job creation have aided California's continuing recovery from the severe recession which ravaged us in the late 1980's and the early 1990's.

California's economy is resurging for the first time since the depression era without the benefit of increased spending on defense, without a strong housing market or growth in construction, and that is very important. In the past, whenever we have boomed in California, it has been led by housing and new construction.

New investments in international trade, the entertainment industry, high tech and biotech have spurred the California economy, and I have to say, Mr. Chairman, the best news I can give you today about California, which is really extraordinary—as a matter of fact, I questioned my staff on it and checked it and checked it—incomes in California grew 7.2 percent in 1995—7.2 percent.

Finally, I think it is important to commend the President for presenting a budget that balances, based on both the estimates of OMB and CBO. This is the first time in 17 years a President has done so. My colleagues on the other side have been calling for a CBO balanced budget plan from the President for months, and I think that was fine that they did that. Now that they have it, I hope it will be a catalyst to get us on with the business of the people. We will have to work together and get something that we both can agree with, both sides.

While the past 3 years have provided a sound and stable economy, there is no doubt we must develop policies which sustain us on that path and the best way to do it is to put the partisanship aside, and I want to address that.

Our Chairman has complained very clearly and very strong today, and other members have, as well, from his side, that it is the Clinton budget that has most of these cuts in the out years. Director Rivlin has stated that, in fact, the Republican balanced budget plan, the last plan that was put on the table, had more cuts in the out years—had more cuts in the out years.

The Chairman complains about trigger mechanisms that will cut unknown programs in the domestic side of the budget when his own submission, the last balanced budget plan on the table, does the exact same thing, and they are even talking about triggering off some of the tax cuts.

So if we are going to make progress here, let us agree that both plans that are on the table contain cuts in the out years, both plans have trigger mechanisms, rather than pointing fingers. We have come a long way together—together—and I hope that we can, in fact, get this job done, because I think the future is very bright for this great country if we do.

Thank you very much.

Chairman DOMENICI. Thank you very much.

Senator Simon, are you next?

Senator SIMON. I believe I am next.

Chairman DOMENICI. I do not know what brought you all today. Was it the rollers on these chairs?

Senator BOXER. Yes. Yes.

Senator DODD. Good chairs. I want to thank you for the chairs.

Chairman DOMENICI. Did you say good chairman? [Laughter.]

Go ahead.

Senator SIMON. I want to join in welcoming Senator Grams and Senator Wyden, who is not here right now, to the Budget Committee, and welcome you here, Dr. O'Neill.

As you have learned from all the questions and comments, we are in the political season. We are in the silly season, if I may say it, where both parties try to take claim and both parties try to blame each other. The reality is, there is plenty of credit and blame to go around to both sides.

The reality is, Bill Clinton deserves credit for his 1993 proposals, which did not receive a single vote on the Republican side of the Senate. The reality is, Pete Domenici and Congressman Kasich deserve credit for having suggested that we balance the budget in 7 years, and initially, there was very little Democratic support for that, and then finally we were embarrassed into coming along.

I would add, I think neither the Republican nor the Democratic proposal for balancing the budget in 7 years will be achieved unless we have a constitutional amendment because we are putting the tough decisions off until the end of that period, and we are doing something else where I differ with both parties. We are asking for tax cuts.

It is very interesting. I saw a poll in Illinois where the public by a three-to-one margin said, should we have tax cuts or should we use this money to reduce the deficit? By a three-to-one margin, the public in Illinois, and I think this reflects the public generally, said, let us reduce the deficit.

I agree with my colleagues, Senator Hollings and Senator Conrad, that the mandate of the law is very clear that we should not use the Social Security funds in balancing the budget. We are in a rut on that.

But let me make equally clear, there is another mandate that did not get into law but is part of the Budget Committee report that we talk about gross interest up front. You have a hard time finding that in the President's budget and in most CBO reports. That is very clear in the report of 1992.

What we do, whether it is President Clinton's proposal or the Domenici-Kasich proposal, the combination has resulted—if you go back to this 1992 document, and I was just looking at it here, the prediction for gross interest expenditure for fiscal year 1996 was \$380 billion. It is now estimated at \$344 billion, a savings of \$36 billion. More than this Government will spend on education, for example, is the savings in interest because of what was done.

Just to illustrate again, the day after the Senate by one vote defeated the Balanced Budget Amendment, the dollar took a record-breaking drop. The day after Senator Domenici and Congressman Kasich proposed that we balance the budget in 7 years, the dollar went up the highest amount it had gone up in 4 years. The financial markets pay attention to what we do and they know the importance of all of this.

Let me ask you about the graph you have here, which totally puzzles me, I have to say. I think you are talking not about discretionary spending, you are talking about the total budget, are you not?

Dr. O'NEILL. This is the Federal debt. Oh, the bottom chart?

Senator SIMON. Leave that other chart up, the previous one. There, you have Federal debt and you talk about discretionary spending. I think you mean the total budget——

Dr. O'NEILL. No.

Senator SIMON [continuing]. Because you have discretionary spending here on your chart right now as about 20 percent of GDP. That would mean \$1.4 trillion.

Dr. O'NEILL. No; total outlays are 21 percent of GDP. Discretionary outlays this year are 7 percent of GDP.

Senator SIMON. That is correct, and your chart, then, is inaccurate.

Dr. O'NEILL. No; this chart refers——

Senator SIMON. That chart does not show discretionary spending at 7 percent. That chart shows discretionary spending about 21 percent there.

Dr. O'NEILL. No, no, no. You cannot really relate this so easily to what discretionary spending would be. This just gives you the assumptions. The dark line gives you some information about one of the assumptions that is——

Senator SIMON. Forget your future projection. Look where we are right now and you will see that that is somewhere around 20 or 25 percent for discretionary spending. What you really mean is that is the total budget. The chart is inaccurate. Discretionary spending, as you just have said, is at 7 percent. The chart is simply inaccurate.

Dr. O'NEILL. No, the chart shows the total——

Senator SIMON. What did you just say discretionary spending is today?

Dr. O'NEILL. Seven percent.

Senator SIMON. Seven percent. Now look at your chart.

Dr. O'NEILL. The chart does not show discretionary spending. The chart——

Senator SIMON. That is what this chart says it shows.

Dr. O'NEILL. No, it——

Senator SIMON. Yes, it does. You read the top lines up there.

Dr. O'NEILL. No, the explanation——

Senator SIMON. Federal debt. Yes, but go down. What does the dark line say? What does the dark line indicate?

Dr. O'NEILL. I am sorry, what——

Senator SIMON. What does the dark line say? That is my question.

Dr. O'NEILL. It says, discretionary spending grows with inflation. It is misleading——

Senator SIMON. What does the dark line say? That is my question.

Dr. O'NEILL. Let me tell you what the dark line——

Senator SIMON. What does the dark line say? Just read it.

Dr. O'NEILL. It says, discretionary spending grows with the economy.

Senator SIMON. And then look at the dark line on your graph. Where is that dark line relative to 100 percent?

Dr. O'NEILL. For 1996, it should be——

Senator SIMON. Nineteen-ninety-six, where are you, roughly?

Dr. O'NEILL. At 50 percent.

Senator SIMON. Where are you roughly on that chart?

Dr. O'NEILL. No——

Senator SIMON. You are somewhere around 20 or 25 percent on the chart. It should be——

Dr. O'NEILL. It is 50 percent. It should show——

Senator SIMON. It should be 7 percent.

Dr. O'NEILL. No, I think this is the misunderstanding, and I admit it is misleading: what the——

Senator SIMON. I am glad you admit it is misleading. It is totally misleading.

Dr. O'NEILL. It is misleading.

Senator SIMON. It is just an inaccurate chart——

Dr. O'NEILL. That was intended to show——

Senator SIMON [continuing]. And I hope the CBO will be more accurate in the future, and I thank you, Dr. O'Neill.

Dr. O'NEILL. Let me explain, so that people are not confused. Since we used two assumptions, the dotted line corresponds to an underlying assumption that the discretionary portion of the expenditures——

Senator SIMON. The lines refer to the total budget, not to the discretionary, so that——

Dr. O'NEILL. It is the total Federally held debt. It is not the budget.

Senator SIMON. It is not discretionary spending.

Dr. O'NEILL. It is not discretionary spending. It is not the total budget.

Senator SIMON. That is the point.

Dr. O'NEILL. It is the total——

Senator SIMON. Somebody who put the graph together made a mistake and it is deceptive. I thank you, Dr. O'Neill, and I thank the Chairman.

Chairman DOMENICI. Thank you, Senator.

Before the wisdom-laden chairman of the Democratic party, whose hair is growing more gray as he grows in wisdom and stature, whose eloquence is becoming more pronounced the better the Democratic party looks, and whose joy is just exuberant as he looks out on the horizon today, just wait a few months. Wait a few months. [Laughter.]

Chairman DOMENICI. Anyhow, would you let me say something, Senator?

Senator DODD. Keep talking. You are doing fine. [Laughter.]

Senator SIMON. You are in trouble with your party.

Senator DODD. We go through this all the time, a mutual admiration society.

Chairman DOMENICI. I said as of right now. I did not say 3 or 4 months from now.

I think what they were trying to say over there was those are two lines showing the entire debt, but it would be slightly affected,

depending upon each of those postulations. That makes it a bit misleading. I think that is what it is saying.

Senator SIMON. I think that is what they were trying to say, only that is not what they said. You are correct.

Chairman DOMENICI. Would you like now, Senator Dodd, to proceed with a very mild-mannered approach?

Senator DODD. Mr. Chairman, I know it may come as a great shock. I have sort of enjoyed listening. Every now and then, it is nice to be here and just participate. I have an opening statement which I will ask your permission to put in the record.

Senator SIMON. You can make it a closing statement.

Senator DODD. A closing statement at this point here, to put in the record.

Chairman DOMENICI. We will be glad to put it in the record.

[The opening statement of Senator Dodd follows:]

OPENING STATEMENT OF SENATOR CHRISTOPHER J. DODD

In America's political climate, we often hear politicians and pundits alike cynically bemoan the supposed lack of forthrightness from our Nation's leaders.

Constantly, we hear the mantra that politicians simply make promises to get elected and then don't deliver once they get into office.

Well today that conventional wisdom has been proven wrong.

Four years ago, Then candidate Clinton said he would cut the Federal deficit in half.

Today, the President is delivering on his promise to the American people.

These new CBO figures show that the deficit is projected to fall to \$144 billion in fiscal year 1996, down from a high of \$290 billion when the President took office 3 years ago. And these new figures are due in large part to the deficit reduction agreement that this Congress passed in 1993.

That plan cut the deficit in half, created more than 8 million jobs, and put America on the right track, toward 3-consecutive years of real deficit reduction—for the first time since the Administration of Harry Truman. And all this with not a single vote from Republicans.

What's more, we've heard over the past few months from my colleagues on the other side of the aisle that the President must present a 7 year balanced budget with CBO numbers.

Speaker Gingrich told Americans that the President "owed" the Nation a CBO-scored, 7 year balanced budget.

My distinguished colleague and the Chairman of this committee, Senator Domenici said "Everything was on the table" except what he called the "sacred commitment" to balance the budget in 7 years with CBO numbers.

Now, as many of you know, I have reservations about this notion of placing rigid timetables for balancing the budget.

It simply doesn't take into account the possibilities of natural or economic disaster or the need for contingency planning.

But, my colleagues across the aisles demanded the President present a 7 year, CBO scored balanced budget.

They even went so far as to shutting down the Federal Government and costing the American taxpayers millions of dollars in order to get their way.

And now today, your own budget office confirms that you got what you asked for: a 7 year balance budget with CBO numbers; the first balanced budget with real numbers, submitted by a President in 17 years.

That's why it is so difficult for me to understand why my Republican friends are not praising this effort as an important first step toward reaching a budget deal.

It makes me wonder if my colleagues across the aisle are truly serious about balancing the budget or if they're just intent on playing politics.

The Republicans' recalcitrance is even more upsetting in the face of the President's budget, which truly invests in people, and protects medicare, medicaid, the environment, education, and other national priorities that are important to all Americans.

This is a budget that maintains our national investments in education, job training and technology. This budget maintains access to health care for our Nation's most vulnerable citizens; the elderly and children. This budget keeps our national

environment and our workplaces safe and healthy while keeping our Nation's streets free of crime. This budget is a common sense approach that forces the Federal Government to live within its means by cutting more than half a trillion dollars in spending over 7 years, yet at the same time maintaining our values and priorities as a Nation.

The President met Republican requests to propose a balanced budget in 7 years, with CBO numbers. And he remains eager to negotiate with Republicans to produce a bipartisan bill based on savings that both sides can agree upon.

What happens next is up to them.

Senator DODD. I would like just to underscore the point that my colleague from Illinois has made and others have made here. We are 29 weeks away from November 5 and obviously this is not unique in the history of the republic. We get near these days and obviously there is a flavor to the conversations and debate and discussion that is inevitably political in some way.

But I do think, clearly, this is good news. There is a tendency to treat all of this somehow as if there is something lamentable that has occurred here. In fact, we are on the right track and we have to keep it up.

The credit goes back and forth, however. Obviously, the President deserves some credit. It is his leadership. Certainly, that is involved. The 1993 budget is clearly a factor. All of us also recognize there have been others who have cared about this issue for a long time. Instead of trying to sort of go through this process of deciding who is going to gain some infinitesimal percentage point in the Richter scale of applause, what we all ought to be saying is, look, we have done a good job here. The President has done a good job. I think we are doing a good job up here. We just have to keep it up. It is all right to applaud, but there is a lot more work to be done. We have come a long way and I just hope that will be the case.

It is critically important, Dr. O'Neill, as you know, that there is a great deal of confidence in CBO, just as there has to be in OMB. This is the great worry that many have, that we are going to end up politicizing offices here where we have to rely—and all of us do, year in and year out—on the integrity of data and information we have received. We have seen what has happened, unfortunately, with some other agencies over the years when they have lost that independence that we all count on.

I know you feel strongly about this, as well, but I just want to make the point. I know there are pressures. The Democrats have been in control and had our people, so to speak, in charge of the office. I can recall grinding my teeth from time to time if the Director of CBO did not have a bit more of a political flavor to their conversation, and to their credit, it did not, and I just hope that will be maintained. It is very, very important.

So this is good news today. We rarely have had good news on these issues over the years and it is good news. I would hope that with that we would encourage our colleagues and those who are here, those who come in the next Congress, to sustain this effort, whether it is Democrats in control if our President is reelected or if Bob Dole is elected. I hope we will maintain the effort. That is what our job really is here. If that is the case, then I think we will all be applauded and all receive the appropriate benefits on election day.

But in the meantime, I guess we are going to have to tolerate some of the rhetoric. But my hope is that we would hear at least what I think is appropriate applause for what we have achieved and still recognize we have more work to do. But we are on the right track, going in the right direction, and it has been a long time. I think we are going to have a fourth straight year now of some deficit reduction. That is good news.

I do not know if you agree with my statement here, and I would be interested. I will put a question mark on the end of it. Is this not good news? Am I missing—

Dr. O'NEILL. Yes; that is what I said myself.

Senator DODD. Every now and then, that gets lost sometimes because some people have a hard time accepting good news. It is a good news message here today, and hats off to all who want to take credit. Thank you, Mr. Chairman. [Laughter.]

Chairman DOMENICI. Thank you. Thank you very much.

Let me make a couple of observations and then yield to our newest member, who wants to inquire.

Senator DODD. Congratulations as well for joining us. I apologize, Mr. Chairman. I meant to extend the congratulations to both of our colleagues who joined us, but I presume you did so willingly.

Senator GRAMS. Yes, I did.

Senator DODD. In which case, I would like to talk to you at some point. [Laughter.]

Chairman DOMENICI. He said that before you arrived.

I just would like to make a couple of observations because there are a few people listening and watching besides the group here. Frankly, it is good news, but essentially, when you get right down to, what have we done, and I say this for everyone, we have not yet changed any of the entitlement programs that we are talking about changing in these proposals.

In other words, the President's proposal gets there, assuming some changes in entitlement programs and some of the other things that I have expressed my concerns about. The Republican package did some entitlement reform, but it is dead. So the American people ought not think that because the deficit is coming down from what it was expected, that it is going to stay down if we do not do some things, and what is left are the tough things.

We barely got through an appropriations cycle. We closed the Government down and all these other things and we are fighting about \$10 or \$12 or \$15 billion. Now we are going to be talking about that much each year, or more, on the appropriated accounts, with it already being pretty tight, and we are talking about reforming welfare to save money, reforming medicaid in a way to save money, reforming medicare so that the trust fund is made solvent, a lot of other entitlements. We have not done those yet.

So while there is good news, we have a real tough job. Will we do those things in this election year? I do not know. A lot of it is going to be up to this committee, whether we want to put it together in order that it get done and whether we can get support on the floor for what we are ordering the committees to do.

So from my standpoint, I remain optimistic. I think we probably have changed attitudes and the overall political landscape to the point where we can be optimistic that there may be a compelling

majority that will try to get it done. I think that is what is being said by my friend from Connecticut and others. The attitude in the White House, the attitude in Congress, not on the extremes, but the huge group of members down the middle want to get these things done now. We were not there a few years ago, so that is good news.

Senator DODD. Yes; I would just say to my colleague, and correct me if I am wrong—he spends a lot more time on this, obviously, the chairman of our committee. These new numbers, it seems to me, make it—again, I do not disagree, we have a lot of work to do, as I said. But it would seem to me we are in a better position now to come to some agreement between the White House and the Congress in the next week or so. It makes it easier. Am I incorrect in saying that the next budget—I know there are going to be offers there to try and get people to that table pretty quickly and it seems to me we ought to take advantage of that. Am I incorrect?

Dr. O'NEILL. You mean the recent budget that the President submitted?

Senator DODD. And this, the news that you are bringing today in terms of where we are makes it easier, it seems to me, for us to at least resolve next year's budget.

Dr. O'NEILL. We are approximately where we were last December in terms of our outlook. The top line of the graph—the other graph, the business-as-usual line, if nothing is done—shows you where we are in 1996. As you have said, the deficit has declined for the last few years and is lower in 1996 than we or anyone had envisioned.

But what our projections show—the top line is current policy, no changes made in anything—is that the deficit left to its own course would rise. That is, of course, not a statement about what will happen, and I am certainly hopeful that—

Chairman DOMENICI. Senator, let me just put it in the way I would to you. The only thing that has really changed is that the appropriation process, as muddled as it has been, seems to have saved about \$20 billion off of baseline and that brings down the estimate from \$164 to \$142 or something—

Dr. O'NEILL. A hundred and forty four.

Chairman DOMENICI. That is because of holding down appropriations. That effort, as you know, has been very tough, very tedious, and very hard. Nonetheless, it looks to have been the main force driving the deficit lower. If the economic news is about the same, according to your projections, as it was—

Dr. O'NEILL. Yes.

Chairman DOMENICI. So it seems like whenever we went down to the White House and started negotiating, we are about in the same position but we have 3 months behind us on saving money on appropriations.

Senator GRAMS, did you have any further questions or observations?

Senator GRAMS. I have just a couple of quick comments.

Chairman DOMENICI. Please.

Senator GRAMS. First of all, I would like unanimous consent to offer my opening statement and also the opening statement from Senator Snowe into the record.

Chairman DOMENICI. They will be so admitted.
[The opening statement of Senator Grams follows:]

OPENING STATEMENT OF SENATOR ROD GRAMS

Mr. Chairman, I want to join you in welcoming our distinguished witness, Dr. O'Neill. With today being my first hearing as an "official" member of the Senate Budget Committee, I am pleased to be focusing on the long-term economic outlook. I am confident that the information we will receive today will reinforce the public support for the enactment of a balanced budget.

Earlier this week, I provided testimony to the Senate Judiciary Committee on legislation I had introduced in January of 1995. This bill, "The Taxpayer Protection Balanced Budget Amendment", provides for a constitutional amendment requiring a balanced budget, and equally important, it required a $\frac{3}{4}$ majority to increase taxes to accomplish the goal.

I believe the taxpayers need a balanced budget, and deserve to be protected from those who would rather raise taxes than find the necessary spending cuts to do so. Unfortunately, we have the status quo today because this President vetoed a plan which not only balanced the budget through spending cuts, but also provided long overdue tax relief.

Furthermore, I believe enactment of a "Taxpayer Protection Lock-box" would put some real teeth in efforts to reduce discretionary spending, while providing the opportunity for tax relief when the economy exceeds predicted growth. It is a simple plan that has been supported by the National Taxpayers Union, Citizens for a Sound Economy and the National Federation on Independent Businesses, but fell victim to a budget point of order earlier this year.

However, I believe the "spending frenzy" which occurred during floor consideration of the Omnibus Continuing Resolution in March was a prime example of why we need such a provision in law. When cuts and assets sales which were intended for deficit reduction under the 1995 Balanced Budget Act were used for increased discretionary spending, the taxpayers lost. While advocates of these amendments claimed a victory, what did the taxpayers get? They got a bigger, more expensive Government and further away from a balanced budget.

While discretionary spending is a concern, we must also consider the devastating economic impact of uncontained mandatory spending. Time and again, we have heard the tireless attacks by the majority on our efforts to preserve the integrity of medicare, provide flexibility to State medicaid programs and end welfare as we know it. The President's veto of the Balance Budget Act put all of these reforms at risk and the taxpayer on the hook. These are all very real issues which need real solutions now if we are to get our Federal debt under control.

Most recently, our colleagues on the other side of the dais have directed their attacks at the unified budget scoring and the Social Security Trust Fund. I find it amazing that after nearly 40 years of Democrat tax and spend policies, policies which have left the trust fund full of treasury notes and spent dollars on pet projects and a government bureaucracy which serves as this Nation's largest employer.

The integrity of the Social Security System is one of the greatest budget risks this Congress will ever face. Maybe not today, but what about the year 2013 when this trust fund will stop running a surplus. The Federal Government will not be able to make good on its promise to give Social Security to those who have paid into the system. And if we have failed to balance the budget and spend down our Federal debt, I believe we will see our economy plummet.

That is why we are having these debates during the 104th Congress. It would be easy to deficit spend our way into favor today, but we will have failed the generations of the future and jeopardized our future economic well-being.

And for these reasons, I commend the Chairman, and my colleagues on this committee for having done the hard work last year. Unfortunately, we are faced with the same challenges this year as we were last, regardless of the lower deficit for 1996. I am sure Dr. O'Neill would agree. And this is why I am pleased to be a member of this committee and to be able to offer some solutions.

Mr. Chairman I look forward to working with you on meeting these challenges in the coming weeks and delivering a balanced budget with middle class tax relief to the American taxpayers. Thank you.

[The opening statement of Senator Snowe follows:]

OPENING STATEMENT OF SENATOR OLYMPIA J. SNOWE

Thank you Mr. Chairman. After reviewing the preliminary report of the Congressional Budget Office on the "Economic and Budget Outlook" for fiscal year 1997–2006, there are two comments I would like to make. First, this report highlights how imperative it is that we enact a plan that *credibly* balances the budget in 7 years. And second, I believe that our expectations for future economic growth are abysmally low and unacceptable.

The need to balance the budget is more compelling than ever. A quick glance at the projected deficits that would result if we continue to follow current policies points to our need to balance the budget. While the deficit projection for 1996 is now at \$140 billion, it would grow by nearly \$30 billion in 1997 and continue to climb to \$287 billion in 2002, and a staggering \$405 billion in 2006. In total, new deficit spending would add nearly \$3 trillion to our already \$4.9 trillion debt over the next 10 years! Not only would this harm our already fragile economy, but it would further exacerbate the onerous financial debt we are imposing on our children and grandchildren.

As I stated during the recent appearance of OMB Director Alice Rivlin before this committee, I believe that we cannot allow our current budget impasse to continue through the coming election. We have a responsibility to make the "tough decisions" needed to balance the budget *today*—not next month or next year. And in the process of making these decisions, we must be responsible and recognize that there is more to balancing the budget than simply "hitting the target" in a certain year.

On the surface, the President's budget "hits the target" in 7 years. However, upon closer examination, his plan looks less like a realistic balanced budget and more like a soufflé. That's right—a soufflé. Just as a soufflé has a lot of "puff" to it but collapses the minute you cut into it, President Clinton's budget merely achieves a "paper balance," and collapses under the most moderate scrutiny. The President's budget is full of gimmicks, backloaded asset sales, and sunsetted tax cuts. And even if his plan were carried out to the letter, President Clinton's grand soufflé would collapse in 2003 as deficits would once again mount and the national debt would continue to rise. Obviously, this can hardly be considered a responsible way to balance the budget.

And as before, the current impasse further emphasizes our need to pass the Balanced Budget Amendment. If we had a Balanced Budget Amendment, the *question* would not be, "*Can we balance the budget this year?*" the statement would be, "*We must balance the budget this year.*" I believe we should give the States and the American people the opportunity to decide if such a Constitutional change is in their best interest. I do not understand those Members of Congress who believe that giving this decision to the American people is wrong. Our constituents have sent each of us to this very body. How can we believe that the very people we represent are not capable of carefully weighing the merits or de-merits of such an amendment?

Finally, I find the merger economic growth projections contained in this report disturbing. I believe we must encourage policies that will lead to greater economic expansion. I *do not* believe that we should be settling for economic growth of 2.1 percent indefinitely in the future. Because with expanded economic growth comes expanded opportunity, expanded job creation, increased wages, and a better standard of living for all of our citizens.

CBO does not craft and adopt the policies that lead to increased economic growth—they simply tell us the way it is. It is the responsibility of the President and Congress to enact policies that will foster this growth. Once again, the President has failed to put forward policies that encourage robust economic growth. The Administration seems more interested in stating how "good" they think our recent 2 percent in real GDP was for 1995, instead of finding ways to *improve* our economic performance in the years ahead. I am hopeful that this committee will heed the warnings of this CBO report, and take action to increase economic opportunity for all Americans in the future.

I would like to thank CBO Director June O'Neill for being here to testify this morning. I am sure that her testimony will shed meaningful light on our current economic and budgetary situation—and will further solidify the commitment of our members to enacting a balanced budget plan this year. Thank you, Mr. Chairman.

Senator GRAMS. I would like to follow up on what Senator Dodd had said. This is good news, but I think all that good news needs to be backed up by integrity, and by that I mean we have to have budgets that are based in reality and not letting figures lie, or vice versa, whatever it might be.

You answered earlier that you cannot comment on spending levels of individual programs and you said because that is up to the discretion of this Congress and the next Congress to make those priority decisions.

Dr. O'NEILL. Yes.

Senator GRAMS. But to make any budget creditable, is it to adhere to the overall goals of that spending? So, in other words, if we set a limit on the budget and hope that that is going to reach balance, that is what we really have to look at, is to make sure that we come in at that level or under on the overall budget, not on individual discretionary decisions?

Dr. O'NEILL. Yes.

Senator GRAMS. So if we set a budget at \$1.6 trillion, we have to come in at \$1.6 trillion and then that limited growth and how we decide on the spending priorities inside that budget can be up for debate, but not to exceed those limits.

Dr. O'NEILL. Yes; that is true, and one hopes that there are policies in place that would get one there.

Senator GRAMS. And that is what you have based the balancing of the budget and the CBO scoring of both the President's plan and the Republican plan, because the President said he would not exceed this growth no matter where those cuts might come and the Republicans have said the same, that we will not exceed this.

Dr. O'NEILL. Yes; it is not our job to question that.

Senator GRAMS. But under your projected growth rates of medicare and medicaid and all the other programs that we are servicing, does our budget or the President's budget have the ability, basically, the integrity, the honesty, to meet those spending limits without these triggers involved? That is a judgment call, I know, but when you look at what medicare is going to grow to, is that figured into your scoring, or do you just take it at face value?

Dr. O'NEILL. The individual entitlement programs are dealt with in all of the balanced budget proposals. There are recommendations for reducing the rate of growth in those programs, and we have estimated whether the policies sketched would in fact get one there, based on what we have seen in the case of the President's budget. In the case of the Balanced Budget Act, our estimate was based on actual legislative language.

Senator GRAMS. I just wanted to make that comment, Mr. Chairman, that we all have the well-meaning intentions and we have set limits. Now the real debate is how do we work out our differences on the priorities that fit inside this package. I just wanted to make that comment. Thank you very much.

Chairman DOMENICI. Thank you very much. For the record, I would just like to make the following observation about a balanced budget and a couple of other things. Frankly, I hope nobody thinks people like myself who work for a balanced budget and who have been doing that for a long time, there is something absolutely spiritual about a balanced budget. Frankly, a balanced budget is meaningful only if it is better policy for the American people than its counterpart of deficit spending, which has accrued \$5 trillion in debt.

I submit that there is not any question. Since Americans do not save very much money, we very, very much need to get the budget

balanced so we stop using that resource and it is available for growth in this economy. It seems to me that also means that interest rates might come down and stay down for a prolonged period of time. Who could ask for anything better for the next generation and for people on fixed incomes and for hard-working Americans?

There is probably one thing we ought to add to the mix and that is that the major—everybody says the major policy document is the budget. I would submit it may be, but the tax policy of the country is more the policy of growth or no growth, of fairness or unfairness.

I submit if we add a balanced budget to a total overhaul of the tax code so that it is sensitized toward growth and investment and savings, if you add the two together and then do some changes in our law regarding protecting our working people for transition training, pensions, portability and the like, we would go a long way toward giving the next generation a better chance at stable wages and get rid of the stagnation that worries us so much about the salaries paid for the people that work in America.

So we have a big role to play and I am very proud of this committee and I just want everybody that is paying attention to us to know we are going to try to put something together that has broader support than in the past, if we can. It will have some Democratic support along with Republican support. But truly, we have to make some hard decisions.

Thus far, I am not prepared to say what our approach will be, but clearly, we are not going to back off getting some major reform for certain in things like medicaid, welfare reform, many of the other entitlements. We have to find a way to get that done this year.

Thanks very much. The committee is in recess until the call of the chair.

[Whereupon, at 12:26 p.m., the committee adjourned, subject to the call of the chair.]





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